Par Pacific

Third Quarter 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator
Good day and welcome to the Par Pacific Third Quarter 2021 Earnings conference call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing star then zero on your telephone keypad. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your telephone keypad. To withdraw your question, please press star then two. Please note this event is being recorded.

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

Ashimi Patel
Thank you, Drew. Welcome to Par Pacific's Third 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're 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. Good morning to our conference call participants. We're very pleased with our third quarter financial results. All our refining units were profitable, and our retail and logistics business segments continued to generate significant profits. Adjusted EBITDA was $85 million and adjusted net income was $0.76 per share. These results include a $29 million non-cash, mark to market benefit for our prior years' RFS compliance.

Wyoming Refining and Logistics profits were particularly notable as the business unit recorded one of its most profitable quarters ever. Strong summer demand bolstered regional product cracks, and excellent operational and commercial execution drove record crude charge and sales volumes.

Hawaii Refining and Logistics profitability continued to improve despite the decline in tourism due to the Delta variant outbreak. Unlike prior quarters, crude oil prices were steady so we experienced very little product price sales lag during the quarter.

In the fourth quarter, Asian market improvements are accelerating. Global refined product demand is increasing with significant increases in international air travel. The impact of Chinese tax reforms and concerns about winter supply have diminished Singapore inventory levels. As a result, current Singapore cracks as well as the forward outlook are close to and at times above mid-cycle. Higher product cracks have also contributed to a tighter crude oil market with increased differentials and very high backwardation. These crude oil factors offset the significant improvement in product cracks.

RINs prices were highly volatile during the quarter as the market reacted to conflicting rumors and administrative comments on the Renewable Fuel Standard. We believe the EPA needs to act quickly to affirm our outstanding small refinery exemption applications and to address 2021 RVO obligation levels.

With the return to profitability and growing liquidity, we are reviewing our capital allocation options. Reducing our cost of capital remains our highest priority and debt reduction is presently the most important element of this effort. We were able to repurchase a small amount of our senior secured notes this quarter. In addition to managing our capital structure, we're also evaluating growth opportunities in our local markets.

In this regard, I'd like to make a few comments about the energy transition. As we consider longer term strategies in our market position, we're exploring various opportunities in the Hawaii and Washington markets in particular. To this end, we'll continue to focus on local needs and leveraging regional strengths, and each market demands a different solution. Hawaii is a fairly difficult market for energy transition initiatives given the lack of any carbon mitigation incentive, high electricity costs and the high cost and complexity of renewable feedstock's. Nonetheless, we are actively exploring concepts that leverage our local resources and address the state's needs.

On the other hand, Washington has provided significant incentives with the passage of a low carbon fuel standard and a carbon emission cap and trade system. The region also benefits from inexpensive, low carbon electricity due to abundant hydroelectric power. Furthermore, our operation is an attractive delivery point for Renewable Fuels and/or feedstock's. Given these features, we're working with local agencies and developers to try and position Tacoma as a leader in the development of hydrogen infrastructure, but this effort will take a considerable amount of time and public support.

We'll continue to focus on smaller projects with more limited capital requirements. Our most significant energy transition efforts will be small capital, high return projects within our refineries as we focus on reducing our carbon and energy profile, while enhancing yields and reducing operating expense.

I'm also pleased to announce that we published our inaugural Sustainability Report. With our focus on community needs, it's important that we demonstrate our adherence to strong ESG standards. This report illustrates our commitment, as well as a corporate culture built on integrity and respect for the environment, our communities, our employees and others.

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

Joseph Israel
Thank you Bill. In the third quarter, the whole system continued to perform safely and reliably as market conditions improved across the board.

Starting in Wyoming, our 3-2-1 index in the third quarter was $41.78 per barrel, driven by strong gasoline demand and crack spreads in our market. Refinery throughput was approximately 18,000 barrels per day, and our realized adjusted gross margin in the quarter, excluding prior period mark to market benefit, was $22.49 per barrel. Our production costs were $5.92 per barrel, reflecting strong execution by our team. So far in the fourth quarter, our Wyoming 3-2-1 index has averaged over $23 per barrel with a relatively strong seasonal demand. Planned throughput is in the 16,000 to 17,000 barrels per day range.

In Washington, our third quarter Pacific Northwest 5-2-2-1 index was $18.59 per barrel, on ANS basis, and our refinery throughput averaged slightly over 38,000 barrels per day. Our realized adjusted gross margin in the quarter, excluding prior periods of mark to market benefit, was $3.75 per barrel, including an estimated negative $0.20 per barrel impact from the diesel hydrotreater catalyst change.

Our production costs in the quarter were $3.60 per barrel.

We recently completed logistics upgrades, which allow us to load ethanol trucks in the refinery rack. The team is exploring additional opportunities to further increase our logistics utilization in renewable service. This activity is not only to support our logistics business and diversification, but also supports our positioning through the energy transition process. So far in the fourth quarter, our 5-2-2-1 index has averaged just under $17.00 per barrel, and our planned throughput for the quarter is approximately 38,000 barrels per day.

In Hawaii, our Singapore 3-1-2 index in the third quarter was $6.20 per barrel on Brent basis, and our realized crude differential averaged $2.27 per barrel premium to Brent. Our throughput averaged approximately 81,000 barrels per day, with the demand recovery best reflected in our yields - approximately 46% of distillate yield in the third quarter, compared to only 31% in the third quarter of last year.

Our realized adjusted gross margin in the quarter, excluding prior period mark to market benefit, was $5.42 per barrel. Our production costs were $4.28 per barrel, including approximately $0.40 per barrel of planned maintenance execution in the reformer and cogent units.

So far in the fourth quarter, our Singapore 3-1-2 Index has significantly improved to approximately $11 per barrel, mostly driven by the high natural gas price, and distillate demand recovery in Asia.

Our estimated crude differential for the fourth quarter is approximately $2.88 per barrel premium to Brent and our throughput target is in the 82,000 to 85,000 barrels per day range.

In summary, we continue to focus on safe, reliable and efficient operations. We are encouraged by the improved market conditions, mostly in Hawaii, and the system is well-positioned to capture the opportunities.

I will leave it there and turn the call over to Will to review our consolidated results.

Will Monteleone
Thank you, Joseph. Third quarter adjusted EBITDA and adjusted earnings were $85 million and $45 million, or $0.76 per fully diluted share.

Focusing on accounting items first, Refining results include a $29 million non-cash mark to market gain related to the 2019 and 2020 RFS compliant years. Excluding the mark to market RINs benefit, our adjusted EBITDA and adjusted earnings per share was $56 million and $0.27 per share, respectively.

Shifting to our segment results, Retail segment adjusted EBITDA contribution was $14 million, roughly flat compared to the second quarter of 2021. Same store sales fuel volumes were up roughly 12%, while merchandise sales were up approximately 3.5% compared to the third quarter of 2020. Hawaii fuel volumes were approximately 88% of pre-COVID levels, reflecting lower levels of international tourist arrivals, particularly on Oahu.

The Logistics segment adjusted EBITDA contribution was $19 million, compared to approximately $20 million during the second quarter of 2021. Steady volumes kept our logistics assets well-utilized during the quarter.

The Refining segment recorded third quarter adjusted EBITDA of $64 million, compared to the second quarter adjusted EBITDA loss of $29 million. Excluding the RIN mark to market impacts, Refining segment adjusted EBITDA was $35 million, compared to a second quarter loss of $2 million.

All units returned to profitable levels.

Focusing upon Hawaii first, Adjusted Gross Margin excluding RIN mark to market slightly exceeded the improvement in market conditions. The third quarter 3-1-2 increased approximately $2 per barrel compared to the second quarter, while Hawaii Adjusted Gross Margin, excluding RIN mark to market, increased approximately $3.25 per barrel.

One of the key issues that has impacted Adjusted Gross Margin capture rates over the last several quarters has been rapid changes in the flat price of oil. Third quarter flat price change was minimal, especially compared to the last nine months. Looking forward, market conditions continue to improve with the 3-1-2 averaging $11 per barrel in October, compared to the $6.20 for the third quarter. However, October ICE CMA Brent was up nearly $9 per barrel compared to the September calendar month average. In addition, backwardation continues to steepen, increasing the cost of protecting our balance sheet from declines in flat price.

Washington adjusted gross margin, excluding RIN mark to market, improved slightly from the second quarter levels due to improved netbacks on asphalt, partially offset by rising backwardation. Asphalt margins tend to widen in falling price environments and compress during rising price environments. As previously mentioned, while volatile across the month, the flat price change was modest across the quarter in aggregate.

Wyoming Refining results reflect a strong summer driving season with attractive capture of the local market environment. There was minimal FIFO impact during the quarter.

Laramie generated adjusted EBITDAX of $26 million and a net loss of $42 million for the third quarter of 2021. Year to date, Laramie generated adjusted EBITDAX of $96 million and a net loss of $1 million. Laramie's third quarter and year to date net income was negatively impacted by unrealized derivative losses totaling $55 million. Year to date capital expenditures have been less than $1 million. Laramie net debt improved from $133 million to $116 million between the July refinancing they completed and September 30.

Laramie exit production as of September 30, was 116 million cubic feet a day equivalent. Laramie is receiving spot market pricing on between 20% to 30% of their production over the next 12 months. Stronger prompt pricing has accelerated Laramie's ability to reduce debt.

Shifting back to the Par Pacific cash flow statement, Par Pacific's third quarter cash flow from operations was $53 million. Excluding the RIN mark to market, working capital was an approximate $12 million source of funds during the quarter. Capital expenditures and turnaround outlays were $8 million. Accrued cash interest expense equaled $14 million. Our net liability for the 2019 and 2020 RFS compliance years totaled $120 million based upon $1.35 per RIN unit. We expect there to be approximately $30 million of working capital outflows related to the 2021 RIN fixed price commitments in the fourth quarter.

Looking forward, we expect our annual cash interest expense to be $50 million to $55 million, and GAAP interest expense to be in the $15 million per quarter range. In addition, consistent with our prior commentary, we expect 2021 annual capex and turnaround outlays to be between $35 million and $45 million.

Our quarter end liquidity totaled $277 million made up of $201 million in cash and $76 million in availability. Our liquidity on hand remains strong and provides flexibility to consider alternatives to reduce our funding costs. As Bill referenced, our top capital allocation priority remains debt reduction.

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

QUESTIONS AND ANSWERS

Operator
We will now begin the question and answer session. To ask a question, you may press star then one on your telephone keypad. If you are using a speakerphone, please pick up your handset before pressing the keys. If at any time your question has been addressed and you would like to withdraw your question, please press star than two. At this time we will pause momentarily to assemble our roster.

The first question comes from Carly Davenport with Goldman Sachs. Please go ahead.

Carly Davenport
Hi, good morning. Congrats on the strong quarter.

My first question was just around high-level capital allocation. With the macro having improved, the setup from our perspective looks constructive as we go into 2022 here. So as you continue to generate cash into next year, how do you think about the uses of that cash? I know that leverage has been the key focus, but curious if when you think about where the stock has been trading relative to the sum of the parts, if there's also a path to incremental capital returns here.

William Pate
Carly, it's Bill. As I mentioned in my prepared remarks, and Will alluded to, our focus will continue to be debt reduction. We don't have any limitations on either repurchasing equity or a significant limitation, say, on repurchasing equity or distributing equity, declaring a dividend. But at this point, I think we're going to be focused on reducing our debt and then obviously exploring some of these small capital projects that we think will help position us for the growth in the future.

Carly Davenport
Great, thank you. And then the follow up was just around opex, and Joseph talked about some of the moving pieces at Hawaii being a bit higher during the quarter. But can you just talk about some of the moving pieces looking forward into 4Q and '22, and just frame perhaps the impact that higher natural gas prices could have on opex or cost of goods sold in their near term?

Joseph Israel
Yes, I reported a $4.28 per barrel opex, so production cost in Hawaii is about $0.80 per barrel higher than the average of our guidance. In our prepared remarks, we explained half of it, $0.40 per barrel is related to the cogen and regeneration maintenance. The other $0.40 per barrel gap is really associated with utility costs. Some of it was the way we price our steam and some of it is related to the cogen maintenance. When we don't operate the cogen, we burn less fuel but we have to buy power from the grid.

And the other aspect in opex in the third quarter in Hawaii was just timing for routine maintenance, especially in our tank farm. So we do believe the $3.50 going forward is a good guidance.

Your second question was about natural gas sensitivity and I will answer it for the entire system. Our sensitivity is very low compared to the typical refiner.

Start with Wyoming. Every dollar per mmbtu change in natural gas has $0.07 per barrel production cost sensitivity for Wyoming, has only $0.02 per barrel sensitivity in Washington, and has pretty much zero in

Hawaii because we don't burn natural gas. We don't buy natural gas in Hawaii. So the weighted average sensitivity for our entire system is only $0.02 per barrel, compared to $0.20 per barrel sensitivity for a typical refinery out there.

Carly Davenport
Great. That's very helpful. Thanks for taking the questions.

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

Phil Gresh
Hey, good morning.

First question, just a bit of a follow up on Hawaii. Recognizing that the crude differential will be $2.88 this quarter, so that's a bit of a headwind. But with where the crack spreads are that you've discussed and other moving pieces, do you feel like there are any headwinds to fully capturing this uplift in the crack spread, given how strong it is?

Will Monteleone
I think the best kind of factors that I've called out that we see as impacting capture rates, again, the third quarter, I think, was strong. And again, a lot of that was we were in a flat price environment where there was relatively minimal change. Obviously, in October, we've seen ICE Brent up nearly $9. And so again, there is some price lag impact for us, but I think it's transitory with respect to rapid changes in crude price. And so I think that's, one factor.

And then again, I think backwardation is the other item I'd call out. Again, we hedge the majority of our inventory in Hawaii. And again, it protects our balance sheet against declines in flat price. And so, again, as we've seen backwardation steepen, the cost of protecting that inventory is going up. So those are the factors, but I think, as you called out, the 3-1-2 is up nearly $5 a barrel, and our crude costs in the fourth quarter are up roughly $0. 60. So, there are some impacts from the rising price but, again, I think we're positively inclined to see where the market is heading right now.

Phil Gresh
Got it. That makes sense. Any initial thinking around the '22 capex with some of these small capital, high return projects? Do you have a way of thinking about the magnitude?

Will Monteleone
I think we'll provide the full year guidance in the next quarter's call, Phil. But I think the only items I'd call out is we've historically commented our maintenance capex is in that kind of $35 million range, $35 million to $40 million. And then we have the Washington turnaround that we called out as planned activity during the first quarter of '22. Again, we'll come out with formal expectations around that, but historically, that's been about a $35 million outlay.

Phil Gresh
Okay, my last question is just around capital allocation in terms of any interest in looking at M&A opportunities. There are some assets on the market, including one just announced by a peer in Alaska as well. So I was just curious if you broadly have M&A interests in particular like niche markets?

William Pate
Yes, Phil, I mean, we've been consistent, I think, in sharing what our strategic area of interest is, and it's PADD four and kind of the upper reaches of PADD five, and there certainly are assets that have been

bandied about. We're also obviously always evaluating opportunities in that area. And certainly with the liquidity we have and kind of coming out of the pandemic, I think we have a little more flexibility, but I think this market environment really requires that we be very disciplined and discriminating as we evaluate our opportunities.

Phil Gresh
Thanks.

Operator
The next question comes from Matthew Blair of Tudor Pickering Holt. Please go ahead.

Matthew Blair
Hey, good morning, everyone. So Laramie had a big increase in profitability that really doesn't flow through into your EPS. Could you provide just an overall update here? What's the plan on drilling going forward? What's the plan on debt reduction? And is there any update in terms of potentially monetizing your 46% investment?

Will Monteleone
Sure, Matthew. It's Will. So I think, as you referenced, a nice step-up in Laramie contribution. Obviously, it's not flowing through our reported results at this juncture. Ultimately, the net debt is down to $116 million, there's a preferred piece of equity that is senior to our common position, which is about $55 million to $60 million. And so ultimately, I think refinancing and getting Laramie to a more sustainable capital structure remains their objective.

And so the fundamentals are improving, the credit metrics are improving, and I think ultimately, you need to see kind of the winter season play out and see the cash flow continue to come in. Their current objectives are to pay down debt. They're not running a rig right now, there's minimal capex. And ultimately, I think de-levering is their principal focus.

Matthew Blair
Sounds good. And then circling back to capital allocation for Par, you mentioned you'd pay down $150 million so far this year. Can you share any targets or goals going forward? How much do you need to pay down to get to a more normalized balance sheet in your view?

Will Monteleone
Sure, Matthew. I think at the end of the day, our preferred capital structure is really to a point where we think about the Refining business very much financed and funded by equity, and our Retail and Logistics businesses being appropriately levered for the type of stability that those cash flows offer. So again, I think we're continuing to monitor those businesses, but they've been stable performers, even through the pandemic. And ultimately, I think, if we can get to probably a consolidated level where we're in the 1.5x range, it probably will give us the cushion that we'd like to have, where the Retail and Logistics businesses are conservatively levered, and we can, again, attract a lower cost of debt capital. That remains one of our key focuses.

Matthew Blair
Great, thank you.

Operator
Again, if you have a question, please press star, then one.

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

Jason Gabelman
Morning, thanks for taking my question. I wanted to first ask about the RIN liability you still have outstanding. You mentioned I think another $30 million of fixed commitments related to RINs in 4Q ’21 Where does that leave you on your 2019 and 2020 RIN obligations? And then also, I guess, on where your accrued 2021 liability is net of your RIN assets.

My second question is on these low carbon energy opportunities. You mentioned hydrogen in Washington, and I don't know if there's something specific in Hawaii, but can you maybe elaborate on those opportunities a little bit more of when you expect to generate earnings that are material for the business from those opportunities? Thanks.

William Pate
Jason, it’s Bill. Let me take the low carbon energy opportunities, and I’ll turn the RIN’s question over to Will. He’s got the harder answer here.

On the low carbon energy opportunities, as I mentioned, the hydrogen, we're really in the very early stages of working with the local authorities, leveraging the fact that they've got low cost hydroelectric power, and looking at converting that into hydrogen for supply to such things as municipal transportation infrastructure, marine infrastructure, generally controlled distribution systems. But we have the space, we've got a balance of utilities that we can help support the development of something there, but it's very early stage, as I mentioned. And still, a lot of dialogue needs to take place within the community to pursue that. But given the federal support for hydrogen, we do think that Tacoma is particularly well-suited for this type of an application.

Turning to Hawaii, really, the high electricity costs preclude any thoughts of something like a hydrogen infrastructure, and we're more focused on our refinery and the fact that we have a steam reforming unit where we're converting naphtha into hydrogen. And that obviously puts us in a position where we think there's some innovative ways potentially to capture carbon, and use and sequester it.

Jason Gabelman
Right.

Will Monteleone
And, Jason, on RINs, again, the 2019 and 2020 liabilities at $120 million. I think once the $30 million outflow is completed in the fourth quarter, we'd expect really to be, let's say, fully purchased on our 2021 obligation. And so again, I think where that leaves us is effectively where, as we head into March of next year, we will have, let’s say, two years of RIN assets and three years of RIN liability accrued on our balance sheet.

And then ultimately, we'll be waiting for action from the EPA, with respect to both the RVO percentages for the 2020 and 2021 years as well as small refinery exemptions, which will impact sort of the aggregate position that we have. I think there's minimal incremental cash outflows planned with respect to kind of the Q1 2022 timeframe. And again, ultimately, the RFS allows you to defer settlement for up to two consecutive years and ultimately that will push kind of cash flows out in the downside case to the 2023 timeframe.

Jason Gabelman
Got it. Just to be clear, so you'd be fully kind of accrued on your 2021 RIN liabilities after these 4Q outflows?

Will Monteleone
That's correct. And ultimately, the cash settlements will reflect the accrual. Again, at this point, we have accrued expense, and again, there have not been cash outflows at this point in time to the tune of about $30 million. If you recall, that was about $40 million last quarter. So again, we did about $10 million of that during the third quarter.

Jason Gabelman
Super, thanks. That's really helpful.

CONCLUSION

Operator
This concludes our question and answer session. I would like to turn the conference back over to William Pate for any closing remarks.

William Pate
Thank you, Drew. I want to thank our team for their hard work, which drove the record earnings from our business this quarter. Have a good day.

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