Par Pacific Holdings, Inc.

Fourth Quarter 2022 Earnings Call

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CORPORATE PARTICIPANTS

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Will Monteleone - *President*

Shawn Flores - *SVP and Chief Financial Officer*

Richard Creamer - *EVP of Refining and Logistics*

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PRESENTATION

Operator
Good morning, and welcome to the Par Pacific Fourth Quarter 2022 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'll be an opportunity to ask questions. To ask 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, Director of Investor Relations. Please go ahead.

Ashimi Patel
Thank you, Anthony. Welcome to Par Pacific's Fourth Quarter Earnings Conference Call. Joining me today are William Pate, Chief Executive Officer; Will Monteleone, President; Shawn Flores, SVP and Chief Financial Officer; Richard Creamer, EVP of Refining and Logistics; and Danielle Mattiussi, SVP and Chief Retail Officer.

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 Chief Executive Officer, William Pate.

William Pate
Thank you, Ashimi. Good morning to our conference call participants. 2022 was a breakthrough financial year for our company. Early last year, product cracks rebounded from pandemic lows and remained strong throughout the rest of the year. Adjusted EBITDA was $643 million, and adjusted net income was $475 million or $7.93 per share. Nearly all our adjusted net income was converted into cash from operations for the year.

We used our free cash flow to strengthen our balance sheet. We paid down nearly $65 million in funded debt and built our cash on hand by more than $375 million. Consequently, our year-end net debt declined to approximately $25 million.

Our team also announced a comprehensive refinancing of our funded debt this month, further reducing our cost of capital. This financing, coupled with our strong liquidity, leaves us well-positioned to close the Billings transaction. We're targeting a June 1st closing.

Entering 2023, our markets continue to be tight. Global product cracks remained strong due to increasing demand, principally due to China, which has abandoned its zero COVID lockdown policy. As evidence of growing demand, Chinese refiners have curtailed exports in the first quarter. Additional European sanctions on Russian petroleum products have tightened freight markets and increased the cost of exports, improving overall refining economics. These trends are somewhat offset by declining natural gas prices, which tend to reduce refinery operating costs and product cracks. The Chinese reopening has combined with overall increased global air travel to boost jet fuel demand, a key element of our sales slate. In Singapore, the jet regrade, or the difference between the price of jet fuel and ultra-low sulfur diesel, has narrowed considerably and occasionally flipped positive for the first time since 2019.

We're making significant progress on our renewables projects. In this area, our focus remains on smaller scale projects that afford us maximum flexibility given uncertainty surrounding feedstock sourcing, government credit pricing, and overall market dynamics. For example, our Tacoma co-feed project will cost less than $2 million, but it will cover 50% of our D4 shortfall. We expect this project to be running next quarter. We're also completing the engineering for the conversion of a unit in Hawaii to produce sustainable aviation fuel. We believe we can complete this 60 million gallon per year project, including feedstock pretreatment, for less than $1.50 per gallon of annual production capacity.

Our upstream affiliate, Laramie, also completed a refinancing this quarter, redeeming its preferred stock and replacing their existing term loan facility with a new credit facility. We expect an approximate $10 million distribution in March in conjunction with this financing.

I want to congratulate Will Monteleone and Shawn Flores in their new roles as President and CFO, respectively. Like many of our colleagues, they're passionate and highly focused on our corporate mission and strategy, a key reason for our growth and success.

I will now turn the call over to Will to discuss our commercial and operational performance.

Will Monteleone
Thank you, Bill. Before diving into the fourth quarter results, I'd like to thank our team members for their many contributions to our collective success over 2022. Despite the complexities of daily operations, you all managed to run at a remarkable 98% mechanical availability for the year, while the retail team generated a strong financial performance and laid the foundation for future growth. A big thank you to the team for your dedication and hard work.

The Refining and Logistics fourth quarter market backdrop remained firm, rewarding refining utilization rates. Total refining throughput was 134,000 barrels per day, or 86% utilization. During the quarter, our per barrel production costs were $5.42 in Hawaii, Washington was $3.57, and Wyoming was $7.80 per barrel. Production costs per barrel were impacted by minor planned maintenance activities in Hawaii and Wyoming, which modestly impacted throughputs and OpEx.

For the full year, Hawaii production costs were $4.86 per barrel, Washington was $4 per barrel, and Wyoming was $7.32 per barrel, despite increases in energy costs, the first quarter Washington turnaround and planned small maintenance in Hawaii and Wyoming. In an $80 per barrel Brent and $4 Henry Hub price environment, we would expect Hawaii production costs between $4.25 and $4.50 per barrel, Washington near $3.50 per barrel, and Wyoming between $7.50 and $8 per barrel. From an overall reliability and operations standpoint, we have no major planned maintenance activities in 2023.

Shifting to commercial matters. The fourth quarter Singapore 3-1-2 index declined approximately $4 per barrel to $22.84. Landed feedstock costs were approximately $9.15 premium to Brent, compared to the initially provided estimate of $8.50 to $9 per barrel. Combining the 3-1-2 and feedstock indexes, the overall margin environment compressed by about $5 per barrel versus the third quarter. Adjusted gross margin declined by a commensurate amount, allowing us to maintain capture rates near 100% of the combined index.

In Washington, market conditions declined by approximately $5 per barrel, but remained seasonally strong at $28 per barrel with very strong conditions early in the quarter. Despite this nearly $5 per barrel drop in the index, we were able to increase adjusted gross margins to approximately $22 per barrel. Improving capture rates were largely driven by wider inland crude discounts relative to ANS and softening backwardation.

Wyoming market conditions declined by approximately $8 per barrel compared to the third quarter. However, Wyoming adjusted gross margin only declined by approximately $2 per barrel, largely due to lower FIFO inventory impacts.

Looking ahead to the first quarter, we expect Hawaii to run between 78,000 and 82,000 barrels per day, Washington between 40,000 and 42,000 barrels per day, and Wyoming between 15,000 and 17,000. In total, this results in a seasonally strong total throughput midpoint of 137,000 barrels per day or 89% utilization.

In Hawaii, the Singapore 3-1-2 has averaged $23 per barrel with notable strength in gasoline and jet fuel offsetting gas oil softening. On the feedstock side, we expect Q1 average crude to land between $8 and $8.50 versus Brent, a modest improvement from the fourth quarter levels. As a reminder, average landed feedstock costs operate on about a 90 to 120 day lag versus prompt quarter market conditions.

In Washington, the PNW 5-2-2-1 index has averaged approximately $30 per barrel quarter to date. The Wyoming index is averaging $49 per barrel, with notable counter-seasonal strength largely due to regional refinery outages.

Moving to the Retail segment. First of all, I'm very excited to announce that Danielle Mattiussi has joined our team to lead the retail business unit. Danielle has a wealth of experience in convenience retail, and I'm excited to work closely with her to take our operations to the next level. The Retail segment generated a record financial quarter with stabilizing fuel volumes and expanding margins across both fuel and merchandise.

Fourth quarter same-store sales fuel and merchandise volumes ramped up nicely, growing 1% and 4.5%, respectively, versus 2021 levels. We completed a three-store acquisition and also have two new to industry sites under construction. The Hele and nomnom brands are well-positioned in their respective regions for future growth.

Key 2023 focus areas are maintaining strong operational reliability, successfully integrating Billings, growing our retail brands, and progressing our renewable projects. With respect to Billings, we continue to be impressed with the high quality of the refinery and logistics team.

Significant transition efforts are underway for a June 1 transaction closing and we remain confident in our synergy targets.

I will now turn it over to Shawn to review our financial results.

Shawn Flores
Thanks, Will. Fourth quarter adjusted EBITDA and adjusted earnings were $175 million and $133 million or $2.20 per share. Full year adjusted EBITDA and adjusted earnings were $643 million and $475 million or $7.93 per share.

The Refining segment reported $146 million of adjusted EBITDA in the fourth quarter compared to $188 million in the third quarter. Fourth quarter adjusted EBITDA includes a net price lag benefit in Hawaii of $10 million, offset by a negative FIFO impact of $4 million in Wyoming and a product crack hedge loss of $4 million in Hawaii. We have continued our crack hedging framework in Hawaii and currently have approximately 25% of our first quarter sales volumes hedged at levels marginally higher than the current market conditions.

The Logistics segment reported $16 million of adjusted EBITDA in the fourth quarter compared to $22 million in the third quarter. The softer Logistics results were primarily driven by one-time pipeline maintenance activities in Hawaii, resulting in increased operating costs, and marginally lower asset utilization.

The Retail segment reported record quarterly adjusted EBITDA of $25 million during the fourth quarter compared to $20 million in the third quarter. As we referenced previously, the strong Retail results were driven primarily by increased margin in fuel and merchandise sales.

Shifting to the cash flow statement. Cash provided by operations during the fourth quarter totaled $132 million, excluding net working capital outflows of $48 million. Working capital outflows were primarily driven by increased RIN settlement activity as we effectively cash settled 60% of our 2022 net RIN obligation during the quarter. Cash outflows from investing activities of $50 million during the fourth quarter include the impact of a $30 million deposit for the upcoming Billings acquisition. Total liquidity at year-end was $577 million, made up of $491 million in cash and $86 million in availability.

Next, I'd like to provide an update on our recent capital market activities. Earlier this month, we announced the successful pricing and allocation of a $550 million senior secured term loan. The new facility will simplify our capital structure, reduce our cost of term debt by approximately 100 basis points, and better position the company to pursue future growth opportunities. The facility is expected to close by early March, and the proceeds will be used to take out our existing Term Loan B and senior secured notes.

As Bill mentioned, 2022 was a breakthrough year for our company. We generated over $450 million of cash flow from operations, which we used to bolster our balance sheet. Our federal net operating loss carryover reduced our cash tax liability by approximately $100 million and was a key factor in achieving our debt reduction objectives. Last year, we paid down $64 million of term debt, repurchased $8 million in stock, and increased our cash position by $379 million, which we will use to fund the upcoming Billings acquisition. As a growth-oriented company, we will continue to identify attractive development opportunities to enhance our integrated supply network across our core markets.

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

QUESTION AND ANSWER

Operator
We will now begin the Q&A session. To ask a question, you may press star then one on your telephone keypad. If you are using speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star then two. At this time, we will pause momentarily to assemble our roster.

Our first question will come from Neil Mehta with Goldman Sachs. You may now go ahead.

Nicolette Slusser
Hey, good morning. This is Nicolette Slusser on for Neil Mehta. Thanks for taking our question. And congrats, Will and Shawn, on the new respective roles. So the first question here would be on Billings. And as we approach the targeted 2Q close date for the transaction, can you just talk about what key factors we should be looking out for ahead of close? And then any thoughts around expected timing within the quarter?

Will Monteleone
Nicolette, it's Will, good morning. So again, I think key factors we've laid out to date, we're targeting the June 1 closing. Again, we're on track for that. And I think are focused on the key items that relate to achieving that date, again the carve-out audit and ultimately standing up the technology and since it's necessary. Again, I think in terms of the overall project, again, I think we remain confident in our synergy targets. We've spent a lot of time on the ground with the team. And again, our belief that the overall overhead, commercial, and operating targets are achievable. And again, I think are focused on -- and again, have identified on top of that opportunities for us to deploy low capital items that will generate high returns to increase reliability.

Nicolette Slusser
Thank you for the color. And then the second question here is just on Hawaii, and I think most are trying to get to a better sense of normalized longer-term EBITDA for the business. Can you talk about what factors may be driving a higher capture rate outlook for Hawaii refining that may be more structural going forward?

William Pate
Shawn, you want to cover the capture? And let me just say, first of all, Nicolette, that the refined products market in Singapore continues to be very strong. And generally, it's trading kind of with the European market on the basis of arbitrage economics. But just to give a little color, the 3-1-2 peaked at $45 a barrel in June of 2022, and it's been trading in the high teens to the low 20s for most of this year. What we're seeing overall is just gasoline and jet have improved as diesel comes off highs.

The market seems to have built in a premium right now for Chinese demand rebound related to the cessation of their zero COVID lockdown policy. And I think one interesting telltale is the regrade that I mentioned in my prepared remarks, with jet really coming up and trading in parity with diesel. I think that's a sign of a healthy market. Longer term, I think the other factors to focus on is Chinese actions continue to be very supportive of their longer-term policy message that they will deliver -- that they will the cease delivery of clean refined product exports by 2025.

Shawn, do you want to go ahead and cover the capture?

Shawn Flores
Yes, Nicolette. As far as capture looking forward, you know, I think we feel like the recent capture rates in Hawaii, looking back to Q3 and Q4 of last year are sustainable. Obviously, we had some price lag benefits in each of those quarters. But as we look ahead, the easing backwardation environment should offset those price lag benefits that we got in recent quarters. And so I expect capture to hold in pretty closely with the prior two quarters.

Nicolette Slusser
Very helpful. Thank you.

Operator
Our next question will come from Matthew Blair with Tudor Pickering & Holt. You may now go ahead.

Matthew Blair
Hey, good morning, Bill, Will, and Shawn, and congrats on the Q4 results. The release mentioned the $10 million distribution coming from Laramie, which it sounds like it stems from the refinancing. But now that the debt is in a better place, could you talk about the prospects for future distributions from Laramie to Par just based on the underlying profitability at Laramie?

William Pate
Sure. And yes, you're correct, Matthew. The distribution is related to the refinancing. We essentially completed a $160 million funded facility, and that took out $135 million in liabilities and permitted $25 million in distribution. So we're getting our pro rata share. Going forward, the facility will permit distributions to the extent of a minimum asset coverage ratio, which is based on the NPV of the reserve base and then the level of debt.

The company continues to perform well and actually, in particular, they benefited from the strong market conditions on the West Coast over the winter, which I think was part of the reason that facilitated this distribution. I wouldn't expect distributions to be more common than annual. But based on an early February strip and current hedge levels, we would expect to receive distributions in most years going forward just subject to our drilling investment levels.

Matthew Blair
Any sense based on current strip on what a 2023 distribution might look like to Par?

William Pate

Not at this point. It's really going to depend on how much we commit to drilling and that, again, will depend on the strip. So in a somewhat counterintuitive fashion, the lower the price, the more likely there's going to be a distribution. The higher price, more likely we're going to put money to work to grow our reserve base, which will probably lead to greater distributions post 2023.

Matthew Blair
Okay. And then my follow up is on the Washington CFS or clean fuel standard program. I believe that is scheduled to start on January 1, 2023. So I was hoping you could talk about on the refining side, do you anticipate that buying these credits would impact your refining capture rate at Washington going forward? And then on the renewables side, do you see this as a boost to this coprocessing project that you're working on?

Will Monteleone
Sure. So Matthew, I think what we've observed is that the clean fuels or the CCA aspects of Washington is operating very similar to the way it does in California, where it's similar to the kind of cap at the rack impacts. And so it's principally impacting rack pricing versus the wholesale PNW sub-octane price that you see that OPIS publishes. So I think, again, this is largely a rack impact versus a wholesale price impact. So that's the first part.

So I wouldn't expect major impacts to capture. It will likely impact working capital and some other items as we think about the overall multiyear settlement time frames that will play out in this. So again, I think another environmental credit kind of scheme where we're going to need to manage the overall balances, but I think we feel well-positioned to ultimately recoup the cost of that given our strong logistics network.

And then I think in terms of the coprocessing project, the state is still very early in rolling out some of the specifics around the regs and the way the coprocessing is going to function. So I think TBD on whether coprocessing will qualify for ultimately reducing the carbon intensity of the fuel. But logic would tell you it should over time.

Matthew Blair
Got it. Thank you for your comments.

Operator
Our next question will come from John Royall with JPMorgan. You may now go ahead.

John Royall
Good morning. Thanks for taking my question. So my first question is on maintenance and CapEx. I know you have no major maintenance this year. How should we expect the maintenance cycle to look once Billings is complete? With the fourth refinery, can you stagger them so you maybe have one major turnaround per year? And then relatedly, how should we think about the longer-term CapEx and maintenance in this business annually after Billings is complete? I think you said $95 million for Billings. But just an update on how we should think about the entire system, including Billings.

Will Monteleone

Sure. So I think, you know, I wouldn't call out any changes to our overall maintenance cycle and turnaround cycle for our existing assets. Again, I think just to refresh for you, right? We've typically been running at a maintenance and regulatory CapEx level of about $40 million a year. And then we've had what we'll refer to as amortized turnarounds of about $20 million a year. So again, together, that's been about a $60 million a year overall spend. I would say it's lumpy. 2023 is a year where you don't see us spending a lot on turnarounds given the timing.

So again, I wouldn't call out any specific changes to our plans on the existing asset base. Again, with respect to Billings, I think we called out a maintenance and regulatory requirement of about $15 million a year and then turnaround – amortized turnarounds of about $20 million a year. So again, all in, just shy of $100 million of maintenance and turnaround requirements on a normalized basis.

In terms of timing for Billings, we're still limited on specifically disclosing the turnaround schedule. I think what we would say is we don't see major items in the second half of '23. And again, I think as we referenced, the $20 million a year is a good amortized turnaround number to include. Cash is going to be lumpy. Some years larger than others. But over a five-year time period, this should be a good number for you to plug into your models.

John Royall
That's helpful. Thanks. And then on the retail side, you've shown some nice improvement throughout 2022. You spoke about it a bit in the opener, but maybe you can just talk a little more on the dynamics there around tourism and any other drivers of that strength? And how you think 2023 could shape up?

Will Monteleone
Sure. So I think on the retail side, I think the Hawaii market, again, is a little bit different than the mainland markets. In particular, our store footprint is heavily weighted towards Oahu. Again, and I think we've not seen the full recovery of, in particular, Japanese tourism to Hawaii. It's inching its way back, probably moving towards 40% and 50% ranges of pre-pandemic levels. So again, I think there's some positive macro trends on overall shift in mix and tourism in Hawaii. And then I think as it relates to the overall positioning in the market, we feel good about our overall store portfolio there. The Hele brand has been very well received in the market. And again, I think we continue to look for ways to grow in that market with -- again, we've got one new to industry location that's under construction that should be online this year.

And then with respect to the Pacific Northwest, probably more similar to the mainland markets that you follow for others. But again, the nomnom brand is relatively new in that market. We've gotten some positive feedback. And again, that got some strong momentum there and look forward to working closely with Danielle to grow that business further. So a good foundation. I think we still have some opportunity to continue to improve.

John Royall
Thank you.

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

Our next question will come from Jason Gabelman with Cowen. You may now go ahead.

Jason Gabelman
Good morning. I wanted to ask on capital allocation just given net debt target levels and you're carrying cash on the balance sheet well in excess of what's needed to close the Billings acquisition. So how do you think about capital allocation and priorities of deploying cash moving forward taking dividend, buyback, growth. Comments on all three would be helpful. Thanks.

Shawn Flores
Jason, this is Shawn. I think as we referenced, we're a growth-oriented company, and our near-term capital allocation policies will reflect that strategy. And I think what we said is we want to get through Billings. We want to integrate it. Will mentioned some capital projects that are on the table to increase reliability, which we think will be really attractive. I think after Billings is integrated, we'll turn our focus to identifying other attractive opportunities to enhance our network. And I think after a period of time, if we're unable to identify capital projects, then we'll certainly evaluate returning capital to shareholders. Bill, anything you'd add?

William Pate
No. That’s good.

Jason Gabelman
Got it. And in terms of the inorganic growth aspect, are there areas that are more attractive, either regionally or by asset type?

William Pate
Jason, this is Bill. I've said this before, and I'll say it again, we're really, first of all, focused on closing and integrating Billings. But even beyond that, we continue to look at the same area, and we continue to look at the same avenues of growth: investing in renewables, which we're doing right now, and we expect to continue to do; adding to our retail footprint, which we're doing with the new-to-industry builds as well as the recent acquisition, which is going quite well; and then obviously, within our market, PADD 4 and PADD 5, we'll continue to look at communities that -- additional communities that we can serve through additional refinery acquisitions.

Jason Gabelman
Understood. And just one more on -- there was an inflow on cash from financing, I think, of almost $15 million. Can you disclose what that was related to?

Shawn Flores
Yes, Jason, I think it was a number of small items. I think one I'd call out is we finance our prefunding on our insurance premiums. It's roughly $15 million to $20 million. And so that's sort of -- it's located in two places. You'll see it as an inflow in the financing section and an outflow in the cash from ops. The other small item was just general funding of our working capital in Hawaii under the delayed draw facility, but not a big impact.

Jason Gabelman
Okay. Good. Thanks a lot.

CONCLUSION

Operator
There appears there are no further questions. 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, Anthony. I want to thank everybody for joining us this morning. This is an exciting time for Par Pacific. And with a favorable market outlook, we look forward to closing and integrating the Billings acquisition and the continued growth of our company. Have a good day.

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