Par Petroleum’s CEO Joseph Israel on 1Q 2015 Results – Earnings Call Transcript

Par Petroleum Corporation (NYSE MKT:PARR)
1Q 2015 Earnings Conference Call
May 11, 2015 10:00 AM ET

Executives

Joseph Israel
Chief Executive Officer, President and Director

Christopher Micklas
Chief Financial Officer and Principal Accounting Officer

William Monteleone
Senior Vice President of Mergers & Acquisitions, Director
Member of Executive Committee and Member of Operations & Technology Committee

Brice Tarzwell
Chief Legal Officer, Senior Vice President and Secretary

Christine Thorp
Director, Investor Relations

Analysts

Adam Michael
Miller Tabak + Co.

Jonathan Segal
Highbridge Capital

Lee Cooperman
Omega Advisors

Presentation

Christine Thorp - Director, Investor Relations

Thank you, Jessi, and good morning, everyone. Welcome to Par Petroleum Corporation's first quarter 2015 earnings webcast and conference call. Joining me on the call today are Joseph Israel, President and CEO; Chris Micklas, Chief Financial Officer; Brice Tarzwell, Chief Legal Officer; and Will Monteleone, Senior Vice President of Mergers and Acquisitions.

Before we proceed, I would like to remind everyone that comments made today by management may contain forward-looking statements. These forward-looking statements may discuss plans, expectations, estimates and projections that involve significant risks and uncertainties, which could cause actual results to differ materially from the results discussed in these forward-looking statements.

Information about the risks we face and the uncertainties associated with Par Petroleum's forward-looking statements can be found in the company's periodic reports filed with the SEC. Because of these risks and uncertainties, investors should not place undue reliance on forward-looking statements. We assume no obligation to update or revise any forward-looking statements to reflect new or changed events or circumstances.

Today's call is being recorded and will be available for replay, following this call, on the Investor Relations section of our website.

I will now turn the call to Joseph Israel.

Joseph Israel - President and Chief Executive Officer

Thanks, Christine. Good morning, everyone, and thank you for joining Par Petroleum's conference call. After my opening remarks, Chris will review our numbers in more detail. Then we will open up the call for your questions.

This morning we reported Par's first quarter adjusted EBITDA of $22.4 million. Results were driven by favorable market conditions, record-high refinery throughput and sales volume for our company.

On-island sales continue to be our main business focus, and including the Mid Pac supply agreement as of January 1, we sold over 60,000 barrels per day on-island in the first quarter compared to 50,000 barrels per day in the first quarter of 2014. In addition, in the first quarter, favorable market conditions supported 22,000 barrels per day of exported products for a total of 82,000 barrels per day sales volume compared to 66,000 barrels per day in the first quarter of 2014.

Refinery outages in the West Coast and Asian demand growth even through a soft-patch environment in the first quarter of 2015 have supported Mid Pacific refining margins. Improved Singapore and West Coast product markets gave us $9.09 per barrel, 4-1-2-1 crack spread on a Brent basis in the first quarter of 2015, $2.25 per barrel more favorable than the first quarter of 2014.

The oversupplied global crude market and specifically the increased North American crude production gave us a Brent minus $2.42 per barrel Mid Pacific differential during the quarter, which was $1.73 per barrel more favorable than the first quarter of 2014.

Progress continues across the board with safe refinery operations and higher efficiency. As expected, our increased throughput profile at 75,000 barrels per day in the first quarter has supported lower direct production expense of \$4.12 per barrel compared to \$4.64 per barrel full year 2014 average. Hedges are in place for 74% of our internally consumed fuel until March of 2016, with annual cost savings of approximately \$20 million at 2014 crude price environment.

Our refinery yield has shifted from 33% fuel oil production in the first quarter of 2014 to 21% in the first quarter of 2015. Our distillate production went up from 38% to 45%, and gasoline production increased from 24% to 27% between the same periods. In March and April, we started to make and sell asphalt for on-island use to improve our flexibility.

Our retail segment contributed \$6.5 million of adjusted EBITDA in the first quarter, with a strong continuous progress in all categories. Gasoline volume and merchandise sales were up 7% and 14% respectively compared with the first quarter of 2014.

On April 1, we closed the \$107 million Mid Pac acquisition, and we are estimating an annual contribution of approximately \$15 million of EBITDA from its operations, not including \$5 million from synergies, mainly on the logistic side. In addition, as previously mentioned, we benefit from the Mid Pac supply agreement through increased on-island sales, as reflected in our refinery segment's results.

Piceance our 34% owned subsidiary is now executing the multi-year capital program and four wells have already been drilled and completed in March and April at a cost of \$1.2 million per well, approximately 15% under plan.

Moving on to the second quarter, market conditions continue to be favorable, as the West Coast refineries are expected to increase utilization rates, the Asian demand mid-term outlook for products is strong. Currently, we are experiencing an \$8.55 per barrel 4-1-2-1 crack spread and \$2.46 per barrel Mid Pacific blend differential under Brent.

As a result, we are expecting refinery throughput to average closer to 80,000 barrels per day in the second quarter. For your convenience, both the 4-1-2-1 crack spread and our defined Mid Pacific blend differentials are now available on our website with history and future updates.

And now, I'll turn the call over to Chris to review our first quarter numbers in more detail.

Chris Micklas - Chief Financial Officer

Thank you, Joseph. During the first quarter, net income was \$462,000 or \$0.01 per share, compared with a net loss of \$14.6 million, or a loss of \$0.48 per share, in the first quarter 2014. Adjusted EBITDA for the first quarter was a positive \$22.4 million, an improvement of \$31.5 million compared to a loss of \$9.1 million in the first quarter of 2014.

Our press release provides a reconciliation of the adjusted EBITDA calculation, including the following first quarter 2015 impacts: \$1.1 million in acquisition and integration expenses stemming from our recently closed Mid Pac acquisition; a \$5 million increase in the value of our common stock warrants; \$4.9 million increase of the contingent consideration owed to Tesoro under the earn-out provision of the purchase agreement for our Hawaii refining business; and $1.8 million loss from our equity interest in Piceance Energy.

During the first quarter, we generated $87 million of cash from operations and were able to repay $27 million of outstanding debt. At quarter end, our cash balance totaled $124 million, total debt was $112 million and liquidity was $206 million. The cash generated for the quarter was driven by an adjusted EBITDA of $22 million and a positive change in working capital of $63 million.

As discussed in our previous earnings conference call, our debt at year-end included $27 million related to a partially financed cargo receivable that was repaid in early 2015. After taking into consideration debt repayment for the quarter, our debt-to-capitalization ratio improved to 28% from 32% at year-end. The improvement in operating cash flow during the first quarter allows us additional flexibility to continue our growth strategy.

As previously noted, we closed the Mid Pac acquisition on April 1. The cash consideration for the acquisition was financed with a new credit facility of $55 million in cash on hand. After taking into account the impact of the Mid Pac acquisition, our current liquidity is $132 million.

Now, I turn the call back over to Joseph.

Joseph Israel - President and Chief Executive Officer

Thanks, Chris. In summary, we are all excited with the progress and position of Par Petroleum in the market. With optimized operations and Mid Pac in the mix, we have a stronger profitability profile, with the ability to generate positive cash flow during downside market conditions. Par is a growth oriented, integrated refiner and marketer with $1.4 billion NOL or tax loss carry forward asset. As we continue to focus on safety and optimize operations, we will use our growth platform, focusing on integration and duplicating the business we have.

And now Jessi, we are ready to take questions.

Operator

[Operator Instructions] Our first question is coming from the line of Adam Michael with Miller Tabak.

Adam Michael - Miller Tabak

I wanted to see if I could ask, you guys are now splitting up your retail line, which is helpful on your income statement. And I guess, my question would be when we're looking at kind of the results for Q1, how do they compare versus 2014? And how should we look at the metrics for retail going forward? And how do you measure internally the potential there? And what are the key variables you're looking at?

Joseph Israel - President and Chief Executive Officer

Yes, we started to report the Marketing Segment in the first quarter. Of course with the Mid Pac closing on April 1, a lot more will be included in the second quarter and going forward, as far as information and financial data. We are expecting between HIE Retail and the Mid Pac contribution to have about $30 million to $35 million of EBITDA per year, not in 2015, but for the full year basis. Synergies will be added or contributed in the refining segment, as well as we benefit from the supply agreement with Mid Pac, so $30 million to $35 million EBITDA for that segment.

Adam Michael - Miller Tabak

And then I noticed exports ticked up for the quarter. And I wanted to see, if you could maybe shed a little bit light on how you think about exports, and I guess, leveraging the fixed cost? What's your internal threshold sort of when it makes sense to export an additional barrel? And it sounds like your throughput is going to be inch higher up into Q2, and I'm assuming that most of those volumes will be export related, but maybe just a little more granularity there please?

Joseph Israel - President and Chief Executive Officer

We have a really unique refinery. I mean, we have this 94,000 barrels per day nameplate capacity, which is available for us and sometimes we get very close to that number just on a daily basis, or for a few days. The reason we are unique is because we are limited by on-island marketing sales not capacity. So this is why we have mentioned in the past and we mentioned this quarter, our on-island sales is our main business focus.

However, when the margins are so good it will make sense for us to continue beyond on-island demand and basically cut from the jet fuel imports and offsetting this with lower value export, and therefore increase our throughput use inventories to get there. So what we have in the first quarter was extra inventories about 600,000-plus barrels of extra inventory, so we could pull close to 7,000 barrels per day and together with our 75,000 throughput per day, we were to sell 82,000.

In the second quarter, we are starting low on inventory, and therefore additional sales will have to trigger higher throughput. The benefit of higher throughput for refinery is obvious, operating expense is going down almost by the same ratio. And from $4.6 a barrel direct operating expense average in 2014, we have already demonstrated $4.1 barrel in the first quarter.

Also on the yield, on the liquid recovery, and all kind of other operations aspect this should be really good for us. So we're excited about that. We currently have 60,000 barrels per day on-island sales profile, which we are pushing as high as we can. Hopefully, we'll finish the year closer to 65,000 per day type of profile.

Adam Michael - Miller Tabak

One last one, if I could. I know in fourth quarter you had the benefit of, what I think was called, a lag effect that was about $15 million to $20 million of EBITDA due to, I guess, the falling oil pricing. And I believe there is also a second factor, the contango factor, and I know contango and the curve has shrunk from $12 to, call it, $7 a barrel. Could you walk us through when we're looking at fourth quarter versus first quarter that lag effect, and I assume that that's gone away. And then maybe the current contango, if there is any shipping costs that have increased maybe, how we should think about that going forward?

Joseph Israel - President and Chief Executive Officer

This is a very fair good question, because we are new and we want to explain our business to you and the investors, we already said in the fourth quarter that crude price fall of $37 per barrel was a significant dynamic in the fourth quarter. As we have large contractual lag on the utility side, fuel oil as well as distillate, a lot of our sales have a one week to a six weeks kind of lag, so in falling crude price environment we get the benefit.

And we mentioned in the fourth quarter, close to a $20 million benefit because of that. We also had a little bit of that in the first quarter but instead of $37, I believe we ended up with $1.50 type of move and the price really went zigzag, so almost a zero impact.

You are right, you mentioned the contango. Contango was new, and for us being a waterborne averaging three, four weeks on the water floating storage, it was huge for us, because it averages about $2 to $3 a barrel benefit just on the crude we had coming to the refinery. What happened in the first quarter, not only the contango is not as steep as the fourth quarter, but also the world logistic cost caught up, right? I mean, they wanted their share of floating storage and contango dynamics. So this was cut significantly to almost a non-benefit in the first quarter like you would expect the market, a smart market to do.

The third item that you didn't mention was inventory, so we built inventories in the fourth quarter in a falling price environment. This has translated to an inventory gain. In the first quarter, it was the other way around crude price went down. We drew down inventories and it was translated to little bit of a loss.

So between those three dynamics, if you take the $47 million EBITDA and cut the $20 million of lag impact, you’re at $27 million. If you take the inventory and contango effect, you can take another almost $15 million, you're back to $12 million same basis for the fourth quarter.

The market has improved $1 a barrel, so your $12 million is up to a $19 million same basis for the first quarter. We came up with the $22 with some improvements. I think the most important thing for us to realize is with Mid Pac on board, we are adding $5 million of per quarter engine starting from the second quarter, right, starting April 1. It wasn't in our first quarter number. And with the improvements we're doing on the operation side, we are running another $1 a barrel, so call it another $5 million a quarter.

So we should be looking at $30 million to $35 million EBITDA a quarter in these market conditions going forward. And this is very consistent with $100 million EBITDA we explained in the last call near mid-cycle environment. Remember, this is a better market than mid-cycle. So numbers are very consistent, in line with our expectations. We're happy with the progress and moving on.

Operator

And your next question is coming from line of Jonathan Segal with Highbridge.

Jonathan Segal - Highbridge

Couple of quick questions. First, all retail volumes that you disclosed that does not include bogey volumes, correct?

Joseph Israel - President and Chief Executive Officer

Not including Mid Pac volume, correct.

Jonathan Segal - Highbridge

And the Mid Pacific crude differential metric that you continue to give that's telling us basically where below Brent you're buying, correct?

Joseph Israel - President and Chief Executive Officer

Yes -- actually, no, I should rephrase that. The numbers we have given are an index, they're based on a FOB of three different crude grades that we are not disclosing because of commercial reasons that we are giving you as a benchmark. It does not reflect our true delivered cost to the refinery. This is a benchmark. So you would expect deltas in the benchmark to act like a delta on the crude acquisition price for us.

Jonathan Segal - Highbridge

And then as we think about the product yield, which you highlighted earlier, there has been a pretty large transformation on the yield, all of that distillates. Is there capacity in your view to continue to push more distillate volumes on-island?

Joseph Israel - President and Chief Executive Officer

Yes, there is. The island consumes 40,000 barrels per day of jet fuel and it needs about 25% of import. So here is your room, here is our motivation to increase distillate and jet fuel production. We can do it short term or mid-term with different crude slate and we can look later on, at potential configuration change when needed, I'm sure it will have good economics.

Jonathan Segal - Highbridge

And so if we were to think about the assets performance over more of a medium term perspective, would this be the slate that you would guide the market to think about?

Joseph Israel - President and Chief Executive Officer

Yes, it looks like a good balance for now.

Jonathan Segal - Highbridge

Final question from me. Obviously, crude has rallied substantially over the last six weeks. What is the impact of that likely to be in the business kind of on the more near-term basis?

Joseph Israel - President and Chief Executive Officer

So I'll start with the contractual lag. I won't call it a significant rally, but it moved up, so one of our capture realization layers will be negative due to the lag, obviously for this quarter. And there is enough room in the market to deliver a good gross margin and in this volatile margin, one day it will be on the positive side and the other day negative on the crude price trend.

I think the good thing we continue to add on the first quarter as far as volatility and pricing, we added additional hedges around the fuel oil burn, and what we call internally consumed fuel to eliminate the cost increase exposure from our profitability. Remember, we burn about 840,000 barrels a year of fuel oil, and we don't want to increase cost just for an absolute increase of crude price, we have currently 75% hedged around $55 to $60 a barrel type of range until the March of 2016.

Jonathan Segal - Highbridge

That's helpful for the internal consumption, but in terms of the lag, I just want to make sure I understood in terms of the lag business or the lag impact, whatever the move has been thus far that will present some headwind in the current quarter, correct?

Joseph Israel - President and Chief Executive Officer

Yes. But at this point, I wouldn't call it more than $0.30, $0.40 per barrel type of impact.

Operator

Our next question is coming from the line Lee Cooperman with Omega Advisors.

Lee Cooperman - Omega Advisors

I have two questions. I apologize, I think some discussion in the balance sheet took place before I joined the call. But I noticed in the quarter that the interest expense and financing cost went up quite dramatically, but still were generating free cash flow. So I thought that interest expense would be dropping. So could you go through one more time the balance sheet of the company where the debt is fixed, where is it variable and explain why the interest cost is up.

And secondly, I don't know if you wanted to tackle this one, but we're in a highly cyclical business, and most cyclical business as you think in the concept of peak earning power, trough earning and normalized earnings. Do you have any input that you can share with us in terms of the company's view of its peak earning power, normalized earning power and trough earning power, depending upon business conditions?

Joseph Israel - President and Chief Executive Officer

I'll have Chris start with interest, then I'll take it back on the earning power.

Chris Micklas - Chief Financial Officer

So the interest expense, the biggest component of our debt is at the Par corporate level and that interest expense is PIK interest. So as we continue to accumulate that at that level, we increase the interest expense. All other interest expense is tied to LIBOR plus a factor, so small changes in LIBOR can cause increases in the interest expense.

And your question around why haven't we reduce the amount of debt with the cash flow, we just continued to monitor the situation and use the positive cash flow to help pay for the Mid Pac acquisition. We continue to look at our balance of the debt and we'll continue to evaluate the situation.

Lee Cooperman - Omega Advisors

Is there any refinancing opportunity that exists, given present interest rates versus your cost of capital?

Chris Micklas - Chief Financial Officer

Again, we continue to look at opportunities to change the interest rate, and we'll just continue to monitor the situation.

Joseph Israel - President and Chief Executive Officer

Yes, obviously, after one quarter of good results or positive results in the fourth quarter, it was a good start but a little bit early to really work our options. Now we have another good quarter in our hands, and I think now more and more windows of opportunities for us to move on and optimize.

So your other question about earning power, I touched a little bit before and in our previous call, we view our business at $100 million EBITDA per year in mid-cycle environment. I was specific about this quarter potential, having Mid Pac on board and having the other operations improvement on line at the end of the year we should get to $30 million to $35 million EBITDA in this market environment for the first quarter.

Operator

Thank you. Ladies and gentlemen, we have reached the end of our question-and-answer session. I would like to turn floor back over to management for any additional concluding comments.

End of Q&A

Joseph Israel - President and Chief Executive Officer

Thank you, Jessi. In closing, I'd like to thank our employees for their continuous dedication and hard work. Thank you all for your interest in Par and your participation today.

Operator

Ladies and gentlemen, this does conclude today's teleconference. You may disconnect your lines at this time.