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Q2 2018 Par Pacific Holdings Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to the Par Pacific Holdings Second Quarter 2018 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Suneel Mandava, Senior Vice President of Finance for Par Pacific Holdings. Thank you, Mr. Mandava. You may begin.

Suneel Mandava ***Par Pacific Holdings, Inc. - SVP of Finance***

Thank you, operator. Good morning, everyone, and welcome to Par Pacific Holdings Second Quarter 2018 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, please note that some of our comments today may include forward-looking statements as that term is defined under federal securities laws. Such statements include, but are not limited to, those concerning plans, expectations, estimates and our outlook for the company. 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 what is indicated in these forward-looking statements. Because of these, investors should not place undue reliance on forward-looking statements, and we disclaim any intention or obligation to update or revise any forward-looking statements.

I refer you to the latest Forms 10-K and 10-Q Par Pacific Holdings filed with SEC for a more detailed discussion of the major risk factors affecting our business. Further information regarding these as well as supplemental financial and operating information, including reconciliations of certain non-GAAP financial measures to the most comparable GAAP figures, may be found in our press release and our investor presentation on our website at www.parpacific.com or in our filings with the SEC.

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

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

Thank you, Suneel, and good morning to all of our conference call participants. I'm pleased to report another strong quarter of financial results by Par Pacific with adjusted earnings per share of $0.29 and adjusted EBITDA of $36.6 million, a 23% increase over the second quarter 2017 adjusted EBITDA. These results reflect strong sequential improvements as well as solid year-over-year growth. All of our business units contributed to our financial success.

Our Hawaii refining operations reported record on-island sales of nearly 72,000 barrels per day. These sales volumes further enhance the attractiveness of our distillate hydrotreater project given the robust growth in our jet fuel and diesel sales. That project continues to progress on budget and at a pace consistent with the fall 2019 start-up. The recent flattening of the crude oil futures curves and increased availability of physical crudes in the Pacific bodes well for our Hawaii refining unit in late 2018 and 2019. Overall, I'm very pleased with the performance of our Hawaii team in the face of this year's challenging crude oil environment.

Our Wyoming refinery was again a strong contributor with record throughput of 17,300 barrels per day achieved to take advantage of strong Rocky Mountain product cracks. The throughput increase was largely due to excellent operational performance in Newcastle. Wyoming's financial results highlight the benefits to Par Pacific of geographic diversification and exposure to mainline United States crude oil and products markets.

Our Retail segment also reported exceptional business segment profits with adjusted EBITDA of $10.6 million for the quarter despite a nearly 15% increase in crude oil prices during the quarter. We achieved these results due to strong margins in Hawaii combined with the full quarter's contribution from our recent acquisition of retail locations in the Northwest United States. The integration of that unit has gone smoothly, and we're pleased with our Spokane team's performance. Same-store sales for retail fuel volumes were down 4.6% for the quarter, we believe, due to demand declines related to crude oil price increases over the past year.

Finally, our Logistics business segment reported adjusted EBITDA of $10.3 million, a 15% increase over the same period in 2017. The increase was largely due to the strong production and sales volumes in Hawaii and Wyoming throughout 2018, increasing the utilization of our logistics network.

At this point, I'd like to turn the call over to Joseph for his comments on our refining operations.

Joseph Israel ***Par Pacific Holdings, Inc. - President and Chief Executive Officer of Par Petroleum LLC***

Thank you, Bill. Operational performance in the second quarter was very strong for both refineries with favorable market conditions in Wyoming and close to 5-year average crack spreads environment for our Hawaii refinery. In the Mid-Pacific market, elevated crude differentials and a backwardated market structure negatively impacted our crude oil cost in the second quarter. So far, in July and August, as we buy our fourth quarter crude oil for Hawaii, implied differentials are more favorable than the publicly reported differentials, which we use to calculate our weekly Mid-Pacific crude oil differential index.

On the products side, second quarter Singapore gasoline crack spreads are at 3-year's low, mostly driven by global robust supply. Singapore distillate and fuel oil crack spreads have been favorable, driven by strong demand and low inventory. In the second quarter, our combined Mid-Pacific index was $8.13 per barrel compared to $8.96 per barrel during the second quarter of 2017.

Our Hawaii refinery throughput in the second quarter was 74,000 barrels per day with strong 99.7% operational availability. We sold a total of 79,000 barrels per day in the quarter, including a record high 72,000 barrels per day of on-island sales. Our adjusted gross margin was $5.32 per barrel, and our production cost was $3.55 per barrel.

In the third quarter, we will execute our planned 13-days reformer catalyst regeneration and other maintenance. The works will have minimal impact on production, and we expect approximately $4 million of negative impact on adjusted EBITDA with the following breakdown: $0.40 to $0.45 per barrel of missed opportunities in gross margin level, plus $0.15 to $0.20 per barrel in production cost level.

So far in the third quarter, our Mid-Pacific 4-1-2-1 crack spread index has averaged approximately $8.60 per barrel. Our third quarter planned throughput is in the 70,000 to 72,000 barrels per day range. The announced DHT project remains on time and on budget and is expected to position Par very well to capture a strong distillate outlook through the IMO transition.

In Wyoming, our 3-2-1 index was $24.99 per barrel during the quarter. This is compared to $21.47 per barrel during the second quarter of 2017. In the second quarter, our refinery throughput averaged record-high 17,300 barrels per day with strong 99.9% operational availability. 20% of our produced gasoline was premium, high-octane gasoline, resulting in record-high premium gasoline production. 48% of our production was distillates, resulting in record-high distillates and ULSD production in the quarter.

As mentioned in the past, our products slate flexibility combined with our ability to rail and truck oil products to other markets has proven to be a successful strategy to smooth out seasonality and optimize profitability. Our adjusted gross margin in the quarter was $17.09 per barrel compared to $13.08 per barrel in the second quarter of 2017. Production costs in the quarter were low, only $6.14 per barrel, driven by strong reliability and high throughput. We sold 16,600 barrels per day. So far in the third quarter, our Wyoming 3-2-1 index has averaged approximately $24 per barrel on WTI basis.

In the local crude market, we are starting to see early signs of logistics constraints with potential future differentials upside for Powder River Basin, and Bakken barrels, which we consume on a regular basis. Finally, third quarter target throughput in Wyoming is approximately 17,000 barrels per day.

And now I'll turn the call over to Will to review financial results and Laramie highlights.

William Monteleone ***Par Pacific Holdings, Inc. - Chief Financial Officer***

Thank you, Joseph. It was a relatively quiet quarter with minimal financial items worth calling out other than a small FIFO benefit within our Wyoming refinery operations for approximately $2 million. In addition, lower RIN prices drove a $4 million improvement in our gross margin compared to the second quarter of 2017. Cash from operations totaled $19 million during the quarter. Net debt to capitalization was 41%, and total liquidity was $163 million compared to 43% and $123 million at the end of the first quarter.

For the quarter, GAAP interest expense totaled $11 million, and DD&A totaled $12.8 million. During the quarter, capital expenditures totaled $8 million. We continue to expect our capital expenditures to be between $50 million and $55 million for the year as the spending on our Hawaii DHT project ramps up.

Moving to Laramie. Laramie generated approximately $23 million of adjusted EBITDAX and a net loss of $0.8 million, which excludes the impact of $8.1 million on unrealized losses on derivatives. Laramie's LTM adjusted EBITDAX now stands at $78 million with further growth projected during the second half based on expected production increases from Laramie's drilling program. During the quarter, Laramie spud 30 and completed 40 wells, finishing with 61 drilled but uncompleted wells. June exit production was 204 million cubic feet a day equivalent. Laramie is on track to exceed exit production guidance for the year based on completion cadence and well results to date.

While gas prices at the wellhead remain under pressure, liquids contributions continue to offset gas price weakness. During the quarter, liquids revenues represented approximately 33% of total revenue. Unhedged price realizations were as follows: natural gas, $2.08 per Mcf; natural gas liquids, $0.69 per gallon; and condensate at $57 per barrel. Capital expenditures totaled approximately $36 million, leaving a revolver balance of $190 million as of June 30, and debt to EBITDAX of approximately 2.4x. Laramie added hedges during the quarter for both liquids and natural gas.

For the balance of 2018, hedges are in place for approximately 55% of projected natural gas and natural gas liquids production. For calendar 2019, hedges are in place for approximately 21% and 15% of projected natural gas and natural gas liquids production, respectively. Recently drilled and completed well costs in the southern section of Laramie's acreage are averaging roughly $875,000 per well, and completions on 2-column spacing continue to support the 1.7 billion cubic feet equivalent type curves. Through the end of June 2018, Laramie has production data on 56 wells with the new spacing.

Completion activity continues at a good pace and is expected to drive a reduction in the DUC balance by year-end. Full year capital expenditures are expected to remain between $120 million and $140 million, consistent with previously communicated plans. Laramie continues to target free cash flow defined as EBITDAX less CapEx generation by the fourth quarter of 2018 and maintain less than 2.25x debt to EBITDA.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question is from Matthew, Blair, Tudor, Pickering, Holt & Co.

Matthew Robert Lovseth Blair ***Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Executive Director of Refining and Chemicals Research***

So your on-island share at Hawaii was a record high and your margin capture was also pretty solid. Is there a rule of thumb we can use in terms of directly connecting on-island share with capture rates? We see an approximate $4 a barrel tanker cost to move gasoline from Singapore to the West Coast, so I don't know if there's something that you could provide to help us make that connection.

William Monteleone ***Par Pacific Holdings, Inc. - Chief Financial Officer***

Matt, this is Will. I think, generally speaking, we've commented over the years higher on-island sales positively correlates with improved capture and adjusted gross margin on a per barrel basis. I think you can probably see over the last few quarters that our sold volume is in excess of our throughput and that trend is likely to continue, and that's largely due to an increase in import activity on primarily the jet fuel side. So again, while the on-island sale is growing nicely, the margins associated with incremental imports is not as attractive as manufacturing. However, I think that ties in exactly with the attractiveness of our DHT project and again how we've built the jet portfolio and see the growing jet business in Hawaii evolving. And again, the DHT project will allow us to manufacture those barrels locally.

Matthew Robert Lovseth Blair ***Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - Executive Director of Refining and Chemicals Research***

Sounds good. And then you've mentioned that retail had $10.6 million of EBITDA in 2Q. Do you view that as a normalized number for your larger system here? And the reason I ask because we've seen pressure on retail on the mainland in Q2 but wasn't sure if that had spilled over to Hawaii. And then finally, can you comment if retail fuel margins for your legacy Hawaii systems were up or down year-over-year?

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

I really don't want to get into a practice of commenting on our retail fuel margins. But with respect to your question regarding, is this a good trend? I think it's probably indicative of the earnings capability of our entire retail system. We do believe that there are factors this year and this quarter that impacted it. I mean, one of the big factors which is not really evident in our numbers because it was offset by good margins and kind of a rapid reaction as well as just the acquisition and the integration of the Northwest retail, and that's with respect to flat crude oil price increases. Those typically compressed margins a little bit. And also with the crude oil price increases, you do see a little bit of demand destruction which we alluded to.

Operator

We have a question from Mike Harrison, Seaport Global Securities.

Jacob P. Schowalter ***Seaport Global Securities LLC, Research Division - Associate Analyst***

This is Jacob on for Mike. You guys saw a solid year-over-year reduction in production cost per barrel in Wyoming in addition to the record throughput. So could you just give us an update on initiatives you are working on to improve operational performance there? And then where should we expect production cost to go in the back half of the year?

Joseph Israel ***Par Pacific Holdings, Inc. - President and Chief Executive Officer of Par Petroleum LLC***

Yes, this is Joseph. Early operational availability and reliability is the key, as we continue to focus on safe operations. And as we achieve high reliability and high utilization rates, we call for less repairs and maintenance cost. When everything works out smoothly. To do that, there is a good PM, preventative maintenance program, that we execute with a high level of discipline. We invest money in our systems, and we focus on training to get this type of efficiency. I don't think $6.14 per barrel in Wyoming is a sustainable number with this high throughput, and really 100% almost reliability. It's probably the extreme case. I think $7 per barrel in the long term is probably a better indication. And then for Hawaii, I think we will continue to see the $3.50 to $3.75 per barrel type of range in this level of throughput, going forward. So I agree with you, good cost structure, good reliability. We just need to keep it up.

Jacob P. Schowalter ***Seaport Global Securities LLC, Research Division - Associate Analyst***

All right. That sounds good. And then a follow-up. So last quarter we were kind of asking you guys whether the volcanoes in Hawaii were going to negatively impact anything. The record on-island sales pretty much tell us the answer to that. So my question sort of looking at it the other way, given that flights were unaffected and that it was kind of in this one part of the island, do you feel that tourism may have actually sort of improved due to people coming down to maybe check out sort of a rare natural, call it, phenomenon? What did air traffic sort of look like to and from Hawaii during the quarter?

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

Well, keep in mind, the Big Island is one island in the state. And when we look at our numbers, we do see some declines on the Big Island that statistically are different than the trends that we see on other islands. But most of our sales in our business is really built around the state residents and most of our sales are in Oahu, which has the bulk of the state's population. We don't see major impacts to transportation fuel consumption associated with changes in tourism, and I don't think any changes in tourism has had a significant impact on our overall business.

Operator

(Operator Instructions) The next question is from Andrew Shapiro, Lawndale Capital Management.

Andrew Evan Shapiro ***Lawndale Capital Management - Founder, Chairman, President, Portfolio Manager, and Managing Member***

When is likely sort of either or both of our refineries being granted another exemption generating rims RINs for the 2018 calendar year? And when will there be greater visibility on that decision?

Joseph Israel ***Par Pacific Holdings, Inc. - President and Chief Executive Officer of Par Petroleum LLC***

We don't know at this point, Andrew, and there's not much we can really disclose at this point.

Andrew Evan Shapiro ***Lawndale Capital Management - Founder, Chairman, President, Portfolio Manager, and Managing Member***

Not even in terms of likelihood, all right. After the Cenex acquisition, I think you've highlighted that the integration has gone pretty quickly. Is there any additional integration? Or does the Q2 results reflect what we should expect to see going forward?

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

I think the Q2 results reflect the integration cost that we see for the business, so we don't anticipate any additional integration cost associated with Cenex in the remainder of the year.

Andrew Evan Shapiro ***Lawndale Capital Management - Founder, Chairman, President, Portfolio Manager, and Managing Member***

Okay. And if the Cenex acquisition has been digested and your leverage ratios and your increased liquidity indications are there, can you give an update, a feel for kind of where the focus is on additional acquisition strategy, whether you foresee or see bolt-ons that may come in? And are you seeing the deal pricing right now to be excessive or coming into the range that you feel would be accretive enough?

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

Look, it's a good question. We certainly -- I think our team is executing very well right now, and we're well positioned for acquisitions. And our focus will continue to be on acquisitions that have a great fit with our current businesses in the Northwest, in the Rockies and in Hawaii. I'm not obviously going to comment on any conversations or acquisitions that we might be pursuing, but we believe that the growth of this company will revolve around adding to those networks that we have today.

Operator

Mr. Shapiro, there are no further questions in the queue. If you like to continue, please do.

Andrew Evan Shapiro ***Lawndale Capital Management - Founder, Chairman, President, Portfolio Manager, and Managing Member***

Sure. Yes, I only have a few more. Following up on that acquisition issue, on previous calls you said you didn't really have the capital for major acquisitions without an equity raise. I think your capabilities have expanded. That being said, given Par's lower stock price at the time get right now, is there a balance that you go through towards other methods of enhancing shareholder value versus deploying on acquisition? Or because their NOLs are so large, the focus would not be necessarily in returning capitals in other ways like buyback or doing that I don't think would makes sense but that would just get in the way of trying to accelerate our utilization of those NOLs.

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

The NOLs are a factor when we think about the cash flow and the taxable income associated at the enterprise, and we've had taxable income now, we generated net income for the last 7 quarters. So we're well on our way to building a business that's a profitable business. Whether we allocate capital for acquisitions versus return capital to shareholders or, thirdly, repay debt depends a lot on most importantly, are there opportunities out there for us to growth our business with respect to acquisitions? And are those opportunities going to generate returns that are in excess of the returns that our capital demands, that the shareholders demand? If there are no transactions and as we pay down debt, if we get to a certain level with respect our debt-to-cap and we've targeted 30% to 35% as a good base ratio, if we got below that level, we would then start to think about returning capital to shareholders if there were no acquisition opportunities to pursue.

Andrew Evan Shapiro ***Lawndale Capital Management - Founder, Chairman, President, Portfolio Manager, and Managing Member***

Great. And lastly, along the same lines, what's the upcoming non-deal roadshows, investor presentations you got going towards telling the compelling story that this company has?

Suneel Mandava ***Par Pacific Holdings, Inc. - SVP of Finance***

Will and I are planning to attend the Seaport Energy Industrial Conference in Chicago, and that's scheduled for August 28, 29. Later in the year, Joseph is planning to attend the Argus Fuel Oil Summit in Miami. That's scheduled for October 15. And we'll put out notices in the coming weeks.

William C. Pate ***Par Pacific Holdings, Inc. - President and Chief Executive Officer***

Thank you for joining us this morning. I'm pleased with our organization's operational performance across the board. Our team has done a great job of overcoming the crude diffs in the Pacific with strong quarterly financial results. We are well positioned to capitalize on our performance and our existing assets and build on these assets with additional acquisitions. Have a good day. Thank you, operator.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's teleconference. You may disconnect your lines, and have a wonderful day.
