Par Pacific

Third Quarter 2022 Earnings Conference Call

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CORPORATE PARTICIPANTS

Ashimi Patel – *Director, Investor Relations*

William Pate – *President and Chief Executive Officer*

Richard Creamer – *EVP, Refining & Logistics*

Jim Yates – *EVP, Retail*

Will Monteleone – *EVP and Chief Financial Officer*

CONFERENCE PARTICIPANTS

Matthew Blair – *Tudor, Pickering, Holt & Co. Securities, LLC, Research Division - Managing Director of Refiners, Chemicals & Renewable Fuels Research*

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PRESENTATION

Operator
Good day and welcome to the Par Pacific Third Quarter 2022 Earnings Conference call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. And 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 Miss Ashimi Patel, Director of Investor Relations. Please go ahead.

Ashimi Patel
Thank you, operator. Welcome to Par Pacific’s Third Quarter Earnings Conference call. Joining me today are William Pate, President and Chief Executive Officer; Richard Creamer, EVP of Refining and Logistics; Jim Yates, EVP of Retail; and Will Monteleone, EVP and Chief Financial 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 President and Chief Executive Officer, William Pate.

William Pate
Thank you, Ashimi. Good morning to our conference call participants.

We're pleased to announce a second consecutive quarter of strong financial and operating results as all our business segments had strong profitability. Third quarter adjusted net income was $2.88 per share and adjusted EBITDA was $214 million. Our organization is excited to return to a growth posture with our recent agreement to purchase Exxon Mobil's Billings refinery and related logistics assets for $310 million.

As previously noted, this acquisition will double our mainland refining capacity and significantly boost our logistics business. We expect to fund the acquisition next spring with cash on hand.

This quarter, our retail and logistics business segments reported record quarterly adjusted EBITDA. The retail unit benefited from declining crude oil prices during the third quarter. Retail price declines also partially reversed a portion of the demand destruction that we experienced in the spring, when gasoline pump prices spiked to very high levels. Our logistics profitability continued to improve due to increasing throughput and sales throughout our system.

Strong operational reliability, a high exposure to distillate markets and falling crude prices, benefited our refining sector, despite refined product cracks that softened from record second quarter levels. While gasoline cracks have dropped significantly, distillate cracks remain strong due to high natural gas prices and significant incremental demand from gas to oil substitution in Europe and elsewhere. Prompt distillate prices are approximately $40 a barrel above gasoline prices in Singapore. Forward distillate cracks remain at high levels through the end of 2023 due to rising global demand.

The profitability of our business has boosted free cash flow over the past two quarters, bolstering our balance sheet. With over $400 million of GAAP net income generated during the last six months, our book equity is back to pre-pandemic levels. Over the near term, we will focus on successfully closing the Billings transaction and integrating that business into our organization. We expect the Billings operation to be immediately accretive to our earnings and cash flow.

We're also making progress on several renewable energy projects. We have a small co-processing investment in Tacoma, scheduled to be operational in the first quarter. And our joint venture with Hawaiian Airlines to explore sustainable aviation fuel is advancing quickly. The Hawaii SAF project looks very attractive based on the renewables market outlook and current levels of government support. While we are cautiously assessing our feedstock options, and mindful of potential government policy changes, we expect to make a final investment decision next spring. We believe this timeline would permit us to break ground next year and commence operations during early 2025.

We believe we can complete this conversion project at less than $1.50 per gallon of annual production capacity. Collectively, these two projects, in conjunction with our blending operations, would generate enough RINs to fully cover our obligation for all units other than D3's.

We're also working on a green hydrogen project at our Washington refinery that would be highly competitive with a low all-in cost of energy and a low greenhouse gas emissions profile.

I'll now turn the call over to Richard to discuss our refining and logistics operations.

Richard Creamer
Thank you, Bill.

Our three refineries worked hard to maximize operational availability in the third quarter, achieving an average of 96.6% availability.

In Hawaii, we experienced unplanned rate reductions which pushed rates below our guidance for the quarter. Third quarter throughput was 80,000 barrels per day and production costs were $5.14 per barrel. The refinery is running well in the fourth quarter and throughput is expected to be 80,000 to 82,000 barrels per day. The reduced throughput in Q4 is related to planned maintenance activities on one of our gasoline conversion units that we expect will reduce capture rates as we are increasing purchased products and exporting secondary products.

In Washington, we operated extremely well and captured peak margins related to West Coast outages during the quarter. Production costs were $3.43 per barrel, and throughput was 40,000 barrels per day. Fourth quarter throughput is expected to be 40,000 to 42,000 barrels per day. Our investment to de-bottleneck heavy crude capacity during our 2022 turnaround has been successful, and we've been able to increase Cold Lake throughput by more than 10%.

Shifting to Wyoming, we achieved a peak monthly rate in July of 18,600 barrels per day. Production costs were $6.63 per barrel, and throughput was 18,000 barrels per day during the third quarter. Fourth quarter throughput is expected to be 15,000 to 16,000 barrels per day. This forecast includes October downtime associated with the catalyst change-out that has been successfully completed.

I'll now turn the call over to Jim to discuss the retail results.

Jim Yates

Thank you, Richard. As Bill mentioned, the retail segment reported record adjusted EBITDA of $20 million for the quarter, compared to $14 million in the third quarter of 2021. Our same store sales volumes decreased by 1.9%, which compares favorably to reported industry decreases of more than 4%. Merchandise revenue increased by 4.7% over the third quarter of 2021.

While continuing COVID related impacts kept pressure on both fuel and merchandise sales volumes, these headwinds were more than offset by promotional efforts and resilient margins. Store transaction counts continue to recover, with recent indicators suggesting visits higher by approximately 2% year over year. Our early fourth quarter results suggest robust margins continuing to offer strong profitability.

Initiatives to upgrade our store portfolio continue as we entered into an agreement to acquire three existing stores in the greater Spokane market. We anticipate closing this acquisition in early December. We also expect to break ground on two new locations in the fourth quarter. The first, a fuel location in Hawaii and the second, a flagship Nomnom branded convenience store and fueling facility in Spokane. We hope to open both of these locations by the third quarter of next year.

I'll now turn the call over to Will to address company financial results.

Will Monteleone
Thank you, Jim. Third quarter adjusted EBITDA and adjusted earnings were $214 million and $172 million or $2.88 per fully diluted share. We generated record quarterly cash flow from operations of $341 million driven by normalizing working capital in combination with strong earnings.

The Logistic segment adjusted EBITDA contribution was $22 million, up sequentially from the second quarter by approximately $1 million. Refining segment adjusted EBITDA was $188 million, compared to $228 million in the second quarter.

Focusing on Hawaii first, the third quarter Singapore 3-1-2 declined approximately $10 per barrel to $26.43. Feedstock costs were approximately $7.80 premium to Brent. Combining the 3-1-2 and feedstock indexes, the overall margin environment compressed by about $14 per barrel versus the second quarter. However, we are able to maintain a relatively flat adjusted gross margin of $19 per barrel in both quarters.

Product Crack hedging was a modest cost in the third quarter compared to the $51 million second quarter impact. Declining prices also drove improved capture on our lagged pricing contracts. On a percentage basis, Adjusted Gross Margin improved to approximately 104% of the combined market indicators.

October market conditions remain strong, with the 3-1-2 averaging over $23 per barrel. We anticipate fourth quarter landed crude differentials will be between $8.50 and $9 per barrel versus ICE Brent, reflecting steep backwardation and increasing freight costs. We've continued our crack hedging framework and currently have approximately 25% to 30% of our Q4 sales hedged at levels consistent with current market conditions.

As Richard referenced, we have some planned maintenance activities that we expect will reduce finished gasoline production by approximately 500,000 barrels during the quarter. In Washington, market conditions declined by approximately $13 per barrel, but remain seasonally strong at $33. Much like Hawaii, despite this nearly $13 per barrel drop in the index, we were able to maintain roughly flat adjusted gross margins at approximately $20 per barrel.

Improving capture rates are largely driven by increased sales, strong VGO market conditions, wider inland crude discounts relative to ANS, and improving asphalt netbacks in a declining price environment. Backwardation remains a partial offset to these improvements.

Looking forward, October has been volatile, with regional refining outages driving an average PNW 5.2.2.1 of approximately $41 per barrel. WCS differentials continue to widen, providing additional feedstock benefits compared to ANS.

Wyoming market conditions declined approximately $9 per barrel compared to the second quarter to $46 per barrel. Adjusted gross margins declined to approximately $19 per barrel, which includes approximately $14.6 million of FIFO expense, or $8.70 per barrel. Wyoming market conditions remain strong with the October 3-2-1 averaging $51 per barrel.

Laramie generated hedged adjusted EBITDAX of $26 million, unhedged adjusted EBITDAX of $40 million and net income excluding unrealized derivatives of $17 million for the third quarter. Capital expenditures totaled approximately $18 million dollars and exit production as of September 30 was 104 million cubic feet a day equivalent. During the quarter, net debt improved by $14 million, down to $50 million.

Shifting back to the Par Pacific cash flow statement, Par Pacific's third quarter cash flow from operations, excluding turnaround funding, was $341 million. Working capital, excluding turnarounds, reversed as expected with an inflow of $44 million. The largest drivers of the working capital inflow are normalizing AR balances relative to activity levels, and reduced collateral posting to support commercial and hedging activities. Capital expenditures totaled $9 million.

During the quarter, we reduced our gross debt by approximately $14 million, including open market repurchases totaling approximately $10 million face value. Gross debt sits at $519 million. Our cash position grew by approximately $220 million and leaves us well-capitalized to complete the recently announced Billings transaction.

Our quarter end liquidity totaled $495 million, made up of $409 million in cash and $86 million in availability. With the strong market backdrop, we expect to continue building liquidity in anticipation of funding the Billings acquisition in 2023. As previously messaged, we are revising our debt target to between $500 million to $600 million of gross term debt based on incorporating the Billings logistics contribution into our forward thinking.

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

QUESTIONS AND ANSWERS

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

And the first question will come from Matthew Blair with Tudor Pickering and Holt. Please go ahead.

Matthew Blair
Hey, good morning, Bill and Will. Congrats on the results.

William Pate
Thanks, Matt.

Matthew Blair

Just looking at the extremely strong margins in Hawaii, I guess it's a question for Will, could you go through the moving parts here? What kind of benefit did you realize from the fuel oil lag? I think you talked about the hedging impacts, but maybe you could cover that again. And just how should we think about all the moving parts in Hawaii in Q3?

Will Monteleone
Sure. So I think, Matthew, three buckets to think about. So called out the product crack hedging benefit, that was roughly a $5.50 per barrel improvement compared to the second quarter. I think the second factor I referenced was the price lag benefit with the falling prices that we saw during the quarter, roughly a $30 per barrel decline in flat prices, and that was approximately a $7.50 per barrel improvement in price lag. Again, keep in mind, second quarter you had rising prices, third quarter you had falling prices. So again, those two combined end up with a $7.50 benefit in the third quarter. And then again, this was partially offset by roughly $2.50 per barrel higher backwardation costs during the third quarter. All in all, those are the big moving pieces on capture during the quarter that I think drove the strong result.

Matthew Blair
Sounds good. And then there's been a fair amount of industry chatter on the prospects for rising product exports out of China. Could you talk about how you're thinking about that issue and the risk to Par's Hawaii margins?

William Pate
Matthew, this is Bill. Certainly has been a lot of conversation, a lot of rumors, but I think the Chinese policy really hasn't changed that much, which is to internalize their refining capacity to supply the domestic markets. And, as you probably know, they've also espoused that they want to eliminate exports by the end of 2025.

Keep in mind that a lot of their exports are actually going into the tanks of jets and into ships that are in the market. Because to the extent that they're supplying and they're leaving the market, they count that as an export.

But overall, we haven't seen any major changes. I mean, obviously, with the zero COVID policy, it does affect demand there and they do have more length, but so far they've been fairly disciplined. So I think it's all rumor at this point.

I think the entire industry really needs to be more focused on global demand and whether economic conditions decline in the face of the rising interest rates that the central banks are creating, and how that impacts the market. But to date, we've seen nothing. Our demand is strong, continues to be strong, and we really haven't seen any changes in the markets to date. The biggest change is really the spread between distillate and gasoline in the market, which as I mentioned, is at historic levels and I think that really relates to the war and concerns about heating oil demand in the winter.

Matthew Blair
Would you expect that spread to widen? You know, there's talk that Russian product exports would be banned. I think Russia exports about a million barrels a day of diesel. I would imagine that that would also be constructive for diesel cracks in 2023?

William Pate
Yes, I think you're right, but I would also just keep in mind that the economy may be cooling off. I think the biggest factor really is going to be Chinese demand. And that's going to be a factor not just for the Pacific basin but for the whole global market. And if the zero COVID policy is amended in any way and Chinese demand starts to pick up, that's when I think you're going to have a real challenge to supply the

world. And then I think the near term issue is really just going to come down to degree days.

Matthew Blair
Sounds good. Thanks for all the color.

William Pate
Sure.

Operator
The next question will come from Carly Davenport with Goldman Sachs. Please go ahead.

Carly Davenport
Hey, good morning. Thanks for taking the questions. I wanted to just start on the strong retail results. Can you talk about the drivers of the strength there? How much of it would you say was related to macro factors like Hawaii reopening versus things that were more idiosyncratic like the plans that you've talked about in terms of increasing market share across your retail markets? Then on the plans to increase store count, any views on kind of where forward EBITDA potential could be going forward?

William Pate
Let me take those one by one. Just to talk about market context, probably the better way to think about it is what happened in Q2, because I think Q2 was weak relative to trend. Q3 was obviously strong relative to trend. And if you put the two together, the single biggest factor was just rising crude oil prices drove rising pump prices, and that in turn had two impacts in Q2. One was it suppressed demand, you had some demand destruction, and two, margins were down. And then in the third quarter, we had a reversal of that, and that's probably the single biggest factor going on.

I wouldn't say there's been a substantial pickup in demand in Hawaii related to the reopening of Hawaii. Because keep in mind, the state really reopened for the mainland last year. So we're actually still, we're even beyond a year and so the year over year comparisons reflect pretty strong demand in terms of mainland visitors. And actually, we've started to see a pickup in international visitors in Hawaii this year.

Where we really haven't seen a pickup, is the Japanese visitors. And they stay longer, they do drive more, and they spend more which drives employment. And the Japanese visitors still is kind of in the 20% of pre-pandemic range, so that's probably the biggest factor there. But I don't think that's a substantial factor in the 2Q to 3Q trends. I think the macro factors related to price were the biggest factors.

Going to your second question on new stores, with respect to new stores, when we're working through whether it's an acquisition or it's a new build, I think you can assume that we're investing at a level where operating cash flow from that store is going to be in the five to seven times operating cash flow range.

Carly Davenport
Got it. Great. That's helpful. Thank you. And then just on the refining side, I think you mentioned the $8.50 to $9 premium to Brent for crude costs in Hawaii for the fourth quarter. Recognizing that you buy forward quite a bit, can you just talk a little bit about how you expect that premium to evolve over the next couple of quarters based on developments that you've seen in the market more recently?

Will Monteleone
Sure. I think, in general, I think we've seen the market soften a little bit from let's call it peak levels that reflect that kind of fourth quarter differential. I think the biggest factors that are driving waterborne differentials for us today come down to time spreads or the market structure and then also freight. Keep in mind, the freight markets have been disrupted quite a bit by the rebalancing in crude trade flows around

Russian crude movements. And so, I think those are the two biggest factors.

But I would say in general, the peak demand that we saw, and really the barrels that are landing and that we're consuming in the fourth quarter, were procured in the third quarter, which I think is really the timeframe where you saw the highest flat prices and the tightest kind of physical market conditions. And I think, since then you've seen a bit of softening there and it's been consistent with the flat price decline. So again, I think we'd expect to start to see some lower differentials moving forward. That said, I still think we're going to be in an elevated waterborne crude differential market, given the factors I laid out.

Carly Davenport
Understood. Thanks for the color.

Operator
The next question will come from John Royall, with JP Morgan. Please go ahead.

John Royall
Hey, good morning, guys. Thanks for taking my question. If you could just go through in some more detail on the downtime you mentioned during the quarter in Hawaii, looks like there was a throughput and an opex component of the impact there. So just a little more color would be helpful in that.

William Pate
I'll let Will handle the opex, but the downtown was really just related to some unplanned maintenance for some work that we performed on our crude and vacuum units, and that drove some reduced rates through the quarter.

Will Monteleone
Then on the opex side, John, the biggest drivers there were really increased energy costs. We had some tank cleaning expense during the third quarter. I expect some of that's going to continue in the fourth quarter, but it should roll off. And then again, some additional unplanned expense related to the work that we were performing on the crude and the vacuum units. So, I think our absolute opex ended up close to $38 million for the quarter, which is on the higher side for us. And so again, I think those are the primary drivers.

John Royall
Okay, great. Thank you. And then on working capital, you guys had the $120 million headwind in 2Q, you'd guided to a partial reversal there, you got about $44 million back and you went through some of the moving pieces in your remarks. But do you see more of that reversing in 4Q or any other moving pieces we should think about in 4Q, I know price going up would have an impact, and any other drivers there for 4Q working capital?

Will Monteleone
I wouldn't point to any specific items that we think are idiosyncratic and that we sort of can clearly point to would reverse anything. I think it's going to be highly dependent on crude price change in the quarter. So, don't have any specific items that we'd reference to this quarter for you.

John Royall
Thank you.

Operator
The next question will come from Ryan Todd with Piper Sandler. Please go ahead.

Ryan Todd
Thanks. One on kind of the balance sheet and use of cash, your balance sheet took a huge step forward during the third quarter. You're at the lower end of your target at $500 million to $600 million of gross debt. Can you talk about your approach to the balance sheet from here? How you'll look to and how you'll approach – I assume you're still, it would appear you're probably still generating a lot of cash during this quarter. How will you look to use potential excess cash going forward and particularly within the context of the upcoming Billings transaction?

Will Monteleone
Sure. Thanks, Ryan. I think in general our approach is going to be to continue to build cash and liquidity in anticipation of that transaction closing. As we get a finer point on the transaction close date and our cash position into that, we'll begin to think about our alternative cash, deployment alternatives. I think you've heard Bill reference there are a number of other growth alternatives that we're studying. But I think the medium term objectives here are going to be to build our cash position to be well-funded and well-capitalized to close the Billings deal and integrate that successfully.

Ryan Todd
Great. And then maybe just at a high level, as you think about your growth strategy in particular, I mean, you've done a series of kind of successful and attractive transactions building out your PADD 4, PADD 5 capabilities here. I know it probably feels early, since you just announced one and they haven't closed yet. But maybe could you talk about longer term, is the plan to continue to acquire and look for opportunities to build critical mass in those markets? How might your longer term growth strategies evolve from here?

William Pate
Well, as you noted, our key focus right now is just successfully closing the Billings transaction and that's going to take some time and commitment on the part of our team. And as Jim mentioned, we actually are closing a small retail deal at the same time. That's obviously easier to tuck in, but both of those are elements of our growth strategy. And as we've said in the past, we intend to be a growing company, we intend to put capital to work. I think we've demonstrated high returns on investments through acquisitions. We'll continue to look at that, but we also have a lot of organic projects. So I think you'll see us investing in renewables around our existing footprint, and we have a much more robust footprint, once we close Billings. We'll continue to look at building out the logistics system, which also will be growing substantially with Billings. And we'll continue to add to our retail footprint. And, putting all that together, I would not preclude, but we're not particularly focused on extending the number of communities served through additional refinery acquisitions at this point.

Ryan Todd
Thanks very much.

Operator
Again, if you have a question, please press star then one. Our next question will come from Jason Gabelman with Cowen. Please go ahead.

Jason Gabelman
Hey, thanks for taking my questions. First, wanted to ask on the renewable diesel projects you're pursuing, the smaller co-processing at Tacoma, can you remind us on the quantity and any earnings guidance you could give on that? And then on the Hawaii project, any more details on the potential capacity of that SAF project and any thoughts on feedstock sourcing would be helpful? Thanks.

William Pate

Sure. So with respect to the Tacoma project, that's about 500 barrels per day. And that is an RD project. With respect to Hawaii, keep in mind that's actually largely a sustainable aviation fuel project. I mean, we will be producing some other products as part of that, but we're really focused on SAF in Hawaii. It's probably going to be about 4,000 barrels per day in capacity based on the size of the unit that we're converting. And it's premature at this point to really get into feedstock sourcing for Hawaii.

Jason Gabelman
Thank you. Okay. And then, secondly, maybe just a quick one on turnarounds. 2022 was a limited year of turnaround activity for you. Do you have any major turnarounds coming up next year?

William Pate
No, we don't.

Jason Gabelman
Okay. Super. Thanks.

CONCLUSION

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

William Pate
Thank you, operator. With a high distillate yield, our system is perfectly situated for the current market environment and we really look forward to closing the Billings transaction next spring. I want to congratulate our team on another strong operational and financial quarter. Have a good day.

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