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HollyFrontier Corporation (HFC) CEO George Damiris on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-31-19 Earnings Summary

Press Release SEC *10-Q*

EPS of $1.68 beats by $0.24 | Revenue of $4.42B (-7.25% Y/Y) beats by $225.72M

Earning Call Audio

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00:00 -27:54

HollyFrontier Corporation (NYSE:HFC) Q3 2019 Results Conference Call October 31, 2019 10:30 AM ET

Company Participants

Craig Biery - Director of Investor Relations

George Damiris - President and Chief Executive Officer

Rich Voliva - Executive Vice President and Chief Financial Officer

Tom Creery - President, Refining and Marketing

Jim Stump - Senior Vice President, Refining

Conference Call Participants

Matthew Blair - Tudor, Pickering

Carly Davenport - Goldman Sachs

Nicholas Lehmann - JPMorgan

Clay Augumini - BofA Merrill Lynch

Operator

Welcome to the HollyFrontier Corporation's Third Quarter 2019 Conference Call and Webcast.

Hosting the call today from HollyFrontier is George Damiris, President and Chief Executive Officer. He is joined by Rich Voliva, Executive Vice President and Chief Financial Officer; Tom Creery, President, Refining and Marketing and Jim Stump, Senior Vice President, Refining.

At this time, all participants have been placed in a listen-only mode and the floor will opened for your question following the presentation. [Operator Instructions] Please note that this conference is being recorded.

It is now my pleasure to turn the floor over to Craig Biery, Director, Investor Relations. Craig, you may begin.

Craig Biery

Thank you, Cheryl. Good morning, everyone, and welcome to HollyFrontier Corporation's third quarter 2019 earnings call. This morning we issued a press release announcing results for the quarter ending September 30, 2019. If you would like a copy of the press release, you may find one on our website at hollyfrontier.com.

Before we proceed with remarks, please note the Safe Harbor disclosure statement in today's press release. In summary, it says statements made regarding management expectations, judgments or predictions are Forward-Looking Statements. These statements are intended to be covered under the Safe Harbor provisions of Federal Security Laws. There are many factors that could cause results to differ from expectations, including those noted in our SEC filings. The call also may include discussion of non-

GAAP measures. Please see the press release for reconciliations to GAAP financial measures. Also please note any time-sensitive information provided on today's call may no longer be accurate at the time of any webcast replay or rereading of the transcript.

And with that, I will turn the call over to George Damiris.

George Damiris

Thanks, Craig. And good morning everyone. Today we reported third quarter net income attributable to HollyFrontier's shareholders $262 million or $1.58 per diluted share.

Certain items detailed in our earnings release, decreased net income by $16 million on an after-tax basis. Excluding these items, net income for the current quarter was $278 million or $1.68 per diluted share versus adjusted net income of $351 million or $1.98 per diluted share for the same period last year.

Adjusted EBITDA for the period was $523 million, a decrease of $90 million compared to third quarter of 2018. This decrease was principally driven by lower product margins and weaker laid-in crude advantage across our refining system. The refining and marketing segment reported adjusted EBITDA of $425 million compared to $507 million for the third quarter of last year.

Consolidated refinery gross margin was $17.23 per produced barrel and 11% decrease compared to $19.41 for the same period last year. We set a new quarterly crude charge record averaging over 476,000 per day in the third quarter.

Our lubricant and specialty products business reported EBITDA of $38 million compared to $42 million in the prior year, despite improvements in the base oil market. Rack Forward EBITDA was $51 million for the quarter and EBITDA margin was 11% of sales. Weakness in Rack Forward earnings was driven by unfavorable salesman and the impact of macroeconomic headwinds and end markets.

With respect to our Sonneborn acquisition as of September 30th, we have achieved run rate synergies of $10 million and continue to expect long-term synergies of $20 million per year.

Holly Energy Partners reported adjusted EBITDA of $90 million for the third quarter compared to $87 million in the third quarter of last year. The increase was driven by strong third-party volumes and higher spot revenues in our crude oil pipeline systems in Wyoming and Utah, which contributed to a 10% increase in volume year-over-year.

During the quarter we return approximately $260 million of cash to shareholders through our regular dividend and share repurchases highlighting our continued commitment of returning excess cash to shareholders.

For the remainder of 2019, we are focused on completing the term of work in our Cheyenne, El Dorado and Woods Cross facilities and expect to return to normal operations later this quarter. We are pleased with the current strength in product margins across the refining system and look forward to a strong finish to the year.

Looking into 2020 our outlook remains positive. We believe IMO implementation will provide uplift to diesel margin and further discounts to heavy crude barrels. With a light turnaround schedule next year and we are well-positioned to take advantage of strong product margins and improving crude discounts across our refining system.

Now will turn the call over to Jim for an update on our operations.

Jim Stump

Thank you. George. For the third quarter, our crude throughput of 476,000 per day was our highest ever recorded quarterly crude throughput across the refining system. For the third quarter, our consolidated operating cost of $5.94 per throughput barrel was $0.11 lower versus the same period last year on higher consolidated throughput.

In MidCon we ran 294,000 barrels per day of crude. OpEx per throughput barrel is $4.77, a decrease of $0.30 versus the same period last year. Our El Dorado refinery set a new quarterly crude charge rate record during the third quarter, averaging 160,000 barrels per day.

In the Southwest, we ran 107,000 barrels per day of crude. Our operating expense per throughput barrels $5.23 an increase of $0.54 versus the third quarter of last year. This was mainly due to higher than normal operating costs associated with the mechanical problem that we had with our reformer unit, which we repaired this month in October.

In the Rockies, we ran 75,000 barrels per day of crude. Our operating expense was $11.34 per throughput barrel, a $0.38 decrease over the same period last year. As George mentioned due to our significant plant maintenance we expect around 380,000 barrels to 390,000 barrels per day of crude in the fourth quarter.

We are currently wrapping up a scheduled turnaround at our Cheyenne refinery and the ongoing turnarounds at our El Dorado and Woods Cross refineries are expected to be completed on schedule and return to normal operating rates in the second half of the fourth quarter.

I will now turn the call over to Tom for an update on our commercial operations.

Tom Creery

Thanks, Jim and good morning everyone. Third quarter of 2019 we ran 476,000 barrels of crude oil which was composed of 32% Permian and 18% WCF and Black Wax crude oil. Our average laid-in cost was 100 WTI by $5.95 in the Rockies and $0.80 in the MidCon and over WTI by $0.43 in the Southwest.

In the third quarter of 2019 gasoline inventories in the Magellan system started the quarter at 7.1 million barrels and ended the quarter at 6.6 million barrels, current inventories are slightly lower at 6.2 million barrels per day. Group three diesel inventories dropped by 800,000 over the quarter to finish off at 7.6 million barrels current distillate or diesel inventories are at 6.1 million barrels.

Third quarter 321 Cracks in the MidCon were $17.29, $26.78 in the Southwest and $26.85 in the Rockies. In our Southwest and Rockies regions we continue to see higher margins as refinery operations on the West Coast and their problems have affected the markets in Phoenix and Las Vegas.

In the midcontinent, gasoline cracks are trading lower as for refinery maintenance end along with weaker seasonal demand, diesel cracks remain higher however as harvesting has been delayed due to chronic weather.

Crude differentials widened across the heavy barrel and narrowed on the sour slates during third quarter. In the Canadian heavy market, third quarter differentials for WCS at Hardisty averaged $12.24 per barrel. Slightly higher than second quarter levels.

Both the current and the forward market for WCS remains even wider with differentials in the $17 range as the market proceeds incremental crude production coupled with the proceeds positive impact of IMO 2020.

Apportionment on the Enbridge system remains high at 44%, despite the continuation of production curtailments by the Alberta Government. We however are able to purchase and deliver adequate volumes of price advantage heavy crude oil to meet our refining needs.

Canadian heavy and sour runs averaged 72,000 barrels a day at our plants in the MidCon and Rocky regions. We refined approximately 153,000 barrels per day of Permian crude in our refinery system composed of 107,000 barrels per day at the Navajo facility and 46,000 barrels per day at our El Dorado refinery delivered by the Centurion pipeline.

Midland sour differentials averaged the third quarter at $0.50 below WTI, and currently we see the same differential trading at $0.20 above Cushing at new pipeline capacity has come on stream. We anticipate this differentials to narrow through the balance of the year as additional pipes come online.

Our rim expense for the quarter was $8 million, which includes $37 million in small refinery exemption waivers we received for the 2018 year at our Woods Cross and Cheyenne Refineries.

And with that, let me turn the call over to Rich.

Rich Voliva

Thanks, Tom. As George mentioned the third quarter included a few unusual items. Pretax earnings were negatively impacted by a lower cost of market charge of $34 million and Sonneborn integration costs of $4 million. Which are offset by a $37 million reduction in the cost of rims and result of the small refinery exemption granted to our Woods Cross and Cheyenne Refineries from the 2018 calendar year. Table of these items can be found in our press release.

For the third quarter, cash flow from operations was $441 million, including turn around spending of $42 million. HollyFrontier's consolidated capital expenditures were $68 million for the quarter, producing free cash flow of $373 million.

The third quarter strong free cash flow allowed us to return a total of $261 of cash to shareholders comprised of a $0.33 per share regular dividend totaling $55 million and/or purchase of approximately 4.3 million shares of common stock totaling $205 million.

As of September 30th, we had approximately $320 million remaining on our share repurchase program. HollyFrontier has returned over $880 million of cash to shareholders through dividends and share repurchases over the past 12 months, representing a cash yield of 9%.

At the end of the third quarter an eye towards substantial plant maintenance in the fourth quarter, our total cash balance stood at $982 million above our target of $500 million. This strong cash position along with our undrawn $1.35 billion credit facility - total liquidity at over $2.3 billion.

As of quarter end, we have $1 billion of standalone debt and debt-to-cap ratio of 14%. Total HEP distributions received by HSC during the second quarter were $38 million, a 2% increase over the same period in 2018. HollyFrontier owns 59.6 million HEP limited partner units represented 57% of HEP flow with the market value of $1.4 billion as of last night close.

For the full-year of 2019 we have increase our capital spending guidance driven by higher turnaround scope and cost. We now expect to spend between $550 and $590 million for both standalone capital and turnarounds at HollyFrontier Refining and Marketing, $45 million to $50 million at HollyFrontier Lubes and Specialties and $34 million to $40 million for HEP.

And with that Cheryl, we are ready to take questions.

Question-and-Answer Session

Operator

[Operator Instructions] Our first question is coming from Matthew Blair, Tudor, Pickering. Your line is now open.

Matthew Blair

Hey good morning everyone. I want to ask about lubricants, so your Rack Forward EBITDA fell quarter-over-quarter, but your1 volumes improved. Could you just walk through some of the challenges here and does your 2019 guidance of I believe 240 million to 260 million does that still hold?

Rich Voliva

Yes Matthew its Rich. Good morning. So a couple of things here we would point out. First, as we described in our press release and seeing from some of our peers in the lube space, the macro issues are driven by the trade war definitely impacting sales here, particularly on the high end of the finished product side. So for example, we saw new tariffs on sales into China this quarter and we continue to feel indirect impacts on end markets such as autos.

Second issue I would point out is as we discussed on our second quarter call we have some maintenance occurring on the lube extraction unit or the LU at - in the fourth quarter. So we did built some inventory there to smooth sales and handle customers through the fourth quarter.

To your point, looking at our Rack Forward guidance it is going to be a stretch to get there, but it is possible. And then looking into 2020 longer term we are fully confident of where we are in that business $275 million to $300 million of mid-cycle EBITDA.

Matthew Blair

That is helpful, thank you. Are you able to break out the contribution from Sonneborn in the quarter?

Rich Voliva

I don't have that handy, I think no.

Matthew Blair

Okay and then final question. There has been some reports that some pad four refinery assets on the block, it is obviously a market that you are pretty familiar with just wanted to gauge your interest if any in some of these assets.

George Damiris

Matthew this is George. We obviously won't discuss any specific opportunities. I think we have been pretty consistent with our messaging regarding our desire to continue to grow in our preference to stay in inland markets that you mentioned. So you can draw your own conclusions from that.

Having said all that any view would have to be for the right assets the right price where we can bring something more to the table than just cash and where that asset net business can bring something new to our Company as well.

Matthew Blair

Thank you. I'm going to re queue for few more follow-ups. Thanks.

George Damiris

Okay, Matthew.

Operator

Thank you. Our next question comes from Carly Davenport, Goldman Sachs. Your line is open.

Carly Davenport

Hey, good morning. Thanks for taking the questions and congrats on a good quarter. The first is just on WCS, so you started to see differential sliding back out towards real economic here in the fourth quarter. Do you think that IMO 2020 fundamentals or some other factor has been driving move and you remind us on your capacity to run Canadian barrels, especially given the rail allowance deals that was announced this morning by Alberta Government.

Tom Creery

Hi, Carly, good morning its Tom Creery speaking. I will answer the first question first. Yes, we have seen the widen out to $17 and $18. We do believe some of that, a lot of it is basis on IMO 2020 is very difficult to ascertain how much of that move is attributable to IMO 2020, but we have been saying it is going to widen as we get closer to the onset of that program. And when we look at a forward curves, we see it staying at those levels if not increasing through the year 2020.

We truly believe that some of it is basis on the incremental rail rates as you know the Canadian or the Alberta Government has said that if you move it by rail you can move over and above the quota system, so that barrel is the last barrel being moved so it does tend to shut the market price and as we all know rail is a lot more expensive than pipeline economics.

Our volumes that we are able to run that depends on overhead prices and what our LP models are saying typically we are somewhere between through the whole refining network 60, 000 to 100,000 barrels a day if not more depending on market conditions.

Carly Davenport

That is great thank you. And then the second one is on the lubricants business, your guys at market day showed 3Q base level margins were materially improved from prior quarter. From what you have seen so far, do you expect that to sustain here into the fourth quarter and what you kind of see as the biggest factors outside of maybe the macro that you already talked about to watch out for that could swing margin.

Rich Voliva

Hey Carly its Rich. Yes, we are pleased and say what we have seen so far in the lube market is what we - in the base oil market what we have expected which was really a trough in the late first quarter, early second quarter, with some typical seasonality we are basically expected this to grind better from here.

The supply demand balance in base oil improves in the next two years, so we would expect cracks to move with it. To your point, there is usually a little bit of seasonality around year-end, so that is probably something to watch out for, but we are pretty optimistic going forward here.

Carly Davenport

Great. Thanks so much.

Operator

Thank you. Our next question comes from Phil Gresh from JPMorgan. Your line is now open.

Nicholas Lehmann

Hi guys, Nick Lehmann on for Phil Gresh. First question would just be on the working capital. So 1H guys had real strong performance there, it looks like 3Q is kind of neutral. We are just wondering how are you thinking of working capital going into 4Q and now you been carrying the high cash balances, wondering if there is any correlation there.

Rich Voliva

Yes. So basically working capital is roughly neutral you are correct in the third quarter, what we saw was a build in inventory ahead of all the maintenance we have planned here in the fourth quarter, but we would expect to release that inventory in the fourth quarter. Get that benefit accordingly.

Yes and then we kept the higher cash balance into the end of third quarter again with an item maintenance in the fourth quarter and we are going to have above the bill for the work performed and we are going to have some obviously a loss revenue from having asset down so we plan accordingly.

Nicholas Lehmann

Okay. And then just a follow-up there. So how you guys thinking about capital allocation going forward, if you are carrying the higher cash balances you see ability for increase on share repurchases any further thought on dividend increase or are we really just keeping it there for possible M&A.

Rich Voliva

I think we start with our cash waterfall that we always reference which is first and foremost we want to protect the balance sheet in the asset. Secondly would be the dividend, third would be growth capital or acquisition and we view those equally the best returns will win and fourth if we got excess, cash over $500 million we will go to share repurchase.

I think to your point, we obviously would expected a little bit lower pace of buyer - in the fourth quarter again just because we have got this maintenance period going and then we will see how we go into next year. To your question on dividend, we are continuing to review that and balancing that with opportunities to grow our business and then what we are hearing from investors in preferred form of cash return.

I just note that we view the dividend as a commitment to the shareholder, we do not want to overextending and again we want balance our against our total priorities. So still working on that.

Nicholas Lehmann

Okay, great. Thanks and congrats on the quarter.

Operator

Thank you. Our next question comes from Matthew Blair, Tudor, Pickering, Holt. Please go ahead. Your line is open.

Matthew Blair

Thanks. Just one follow-up. So I think yesterday's Seaway announced a 200,000 barrel per day expansion, they are hoping to do that at a tariff of just $1. 25 barrel, I believe. George do you have any thoughts, does this have any implications for narrower Brent WTI differentials going forward?

George Damiris

No. I think directionally the dollar and a quarter that comes to fruition is lower than we would expect for pushing the Houston move. But even factoring this in, it is really the incremental barrels that always sets the price in markets. So when we look forward to the Brent WTI spend, we still feel confident in that five dollars per barrel range.

Matthew Blair

Thank you very much.

George Damiris

Okay.

Operator

Thank you. [Operator Instructions] Our next question comes from Clay Augumini from Bank of America. Your line is now opened.

Clay Augumini

Hey guys I'm on for Dough. So thanks for taking my question. My first is just on the MLP, so one of your peer this morning announced strategic review of their MLP, the market today is just not supportive. Wondering if you can share any updated thought that you guys have of the structure of that business and what the strategic benefit to HFC is?

Rich Voliva

Its Rich, so yes like HEP's unit price performing has been disappointing and confusing to be honest. We are talking about tax differed security with really no commercial risk, 12% yield and in a world where the 10 year treasury is at 1.7. So were incredibly frustrated, but I know we are not also alone

I know we are not also alone.

So all that said, look we are going to do what is best for the shareholders. HEP was really formed for two reasons. First, to highlight the value of these assets within HFC, and HEP is still trading about four return premium to HollyFrontier.

The second was to access the capital markets and clearly that the equity capital markets in particular and clearly broken at the moment. So we will continue to evaluate our options here and monitor how the markets going, late as we sit here right now we don't believe we are buy and make sense.

And really the good news is that we are under no pressure here. HEP is very healthy operationally, commercially at the right amount of leverage, it has got a coverage ratio north of one. So we feel comfortable here and we will continue to monitor the situation.

Clay Augumini

Thanks Rich. My follow-up is just on the quarter. So the - for the Rockies came in very strong. Anything you can offer there?

Rich Voliva

Yes. I think we have couple of things going on there Clay. Obviously in the quarter you will notice we had a small refinery exemptions. So you got to clear those out. With margins in the Rockies particular Salt Lake City were very, very strong and we have a good clear run there this quarter. So I think you should keep that in mind as well.

Clay Augumini

Got it. Thank you.

Operator

Thank you and there are no further questions in the queue at this time. I will turn the floor back over to Craig for any closing remarks.

Craig Biery

Thanks everyone. We appreciate you taking the time to join us on today's call. If you have any questions as always reach out to investor relations. Otherwise we look forward to sharing our fourth quarter results with you in February.

Operator

Thank you. This does conclude today's cost teleconference. Please disconnect your lines at this time. And have a wonderful day.