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HollyFrontier Corp. (HFC)

Q3 2014 Earnings Call

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Ryan Todd
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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the HollyFrontier Corporation's Third Quarter 2014 Conference Call and Webcast. Hosting the call today from HollyFrontier is Mike Jennings, President and Chief Executive Officer. He is joined by Doug Aron, Executive Vice President and Chief Financial Officer and George Damiris, Executive Vice President and Chief Operating Officer.

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

It is now my pleasure to turn the floor over to Julia Heidenreich, Vice President, Investor Relations. Julia, you may begin.

Julia Heidenreich
Vice President-Investor Relations

Good morning everyone and welcome to HollyFrontier Corporation's third quarter earnings call. I'm Julia Heidenreich, Vice President of Investor Relations. This morning we issued a press release announcing results for the quarter ending September 30, 2014. If you'd like a copy of today's press release, you can find one on our website at hollyfrontier.com.

Before Mike, George and Doug proceed with their prepared remarks, please do note the Safe Harbor disclosure statement in today's press release. In summary it says statements made regarding management's expectations, judgments or predictions are forward-looking statements. These statements are intended to be covered under the

Safe Harbor provisions of the federal securities laws. There are many factors that could cause results to differ from expectations, including those noted in our SEC filings. Today's statements are not guarantees of future outcomes.

The call today might also include some discussion of non-GAAP measures. Please see the press release for reconciliations to GAAP financial measures. And please note that any information presented on today's call speaks only as of today, November 5, 2014. Any time-sensitive information provided may no longer be accurate at the time of the webcast replay or any re-reading of the transcript.

And with that I'll turn it over to Mike.

Michael C. Jennings

Chairman, President & Chief Executive Officer

Great. Thanks, Julia. Good morning. Thank you for joining us on HollyFrontier's third quarter earnings call. I'm pleased to have our recently appointed Chief Operating Officer, George Damiris, join us on today's call. George has been a key member of our leadership team since his joining the Company in 2007 and brings with him more than 25 years of refining industry experience.

Today we reported second quarter net income attributable to HFC shareholders of \$175 million or \$0.88 per diluted share. Third quarter EBITDA was \$369 million, only 5% below second quarter EBITDA of \$388 million, despite 7.5% lower throughputs. Improved margin capture driven by strength in co-product cracks, attractive Midland crude differentials and good heavy crude economics helped to offset lower throughput, narrower inland crude differentials, elevated regulatory costs relating to the RFS mandate, and increased product inventory resulting from market access issues in the Rockies.

On a per barrel basis our third quarter consolidated refinery gross margin was \$15.59 per produced barrel. Slightly above the \$14.54 of gross margin recorded in the second quarter of 2014. Realized margins rose sequentially across all regions due to an improvement in capture rates, offsetting a decline of 14% and 4% WTI-based gasoline and diesel cracks in the Mid-Con.

Third quarter came in flat with second quarter earnings despite lower crude throughput, continued cost pressure from RINs, a significantly backwardated WTI curve, and a 30% compression in the Brent-WTI crude spread. I expect the Brent-WTI spread to re-widen as we exit 2014 with the startup of new pipeline capacity into the Cushing storage hub. We've seen a 20% build in Cushing inventories since July to over 21 million barrels and expect the 900,000 barrels per day of Cushing bound crude capacity from Flanagan South, White Cliffs and Pony Express, which should all be operational by year end or early 2015. Along with 700,000 to 1.2 million barrels per day of capacity recently announced around Saddlehorn, Grand Mesa and BTC pipelines from the Bakken and Niobrara to further contribute to Cushing crude availability.

The fourth quarter is off to a good start, driven by a seasonally strong demand in the Mid-Continent and Rockies due to unseasonably warm weather, a strong harvest and continued drilling activity. The Mid-Con sold at a 17% per gallon premium to Gulf Coast gasoline due to tight product inventories. Pad 2 utilization rates fell as low as 82% in the month due to turnaround activity and crude pipeline supply interruptions, forcing some refiners to cut rates. In the coming weeks I expect the Group III premium to the Gulf Coast to moderate with increased utilization rates as refineries exit turnarounds and pipeline issues are resolved.

We continue to invest in our core refining business, focused on increased crude flexibility and liquid yield improvement. Our El Dorado Naphtha Fractionation project is on track for completion mid-2015. This investment will allow us to use natural gas as a source of hydrogen, improve liquid yield and reduce benzene and other coke

products. Our Woods Cross Phase 1 expansion underway will allow us to process greater quantities of black wax crude from the Uinta range. Holly Energy Partners substantially completed the expansion of its Southeastern New Mexico gathering system in September providing increased crude gathering volumes for our Navajo Refinery and connections to major market clearing points.

The completion of Holly Energy Partners' Southeast New Mexico gathering system along with the optimization of HEP's existing pipeline system has increased our access to Permian crudes. If economic, Permian barrels can account for 20% of our Mid-Con crude slate and 35% of our total refining system crude slate. Permian crude is on track to account for a quarter of U.S. crude production. In the Malaga gathering region in the immediate neighborhood of our Navajo Refinery, we expect to see 50% production growth by 2018 to over 560,000 barrels per day.

While crude price is a risk, I do not expect the current weakness in WTI to result in any near-term slowdowns in crude production. I continue to believe in longer term fundamentals driven by crude oil production growth and our refinery locations close to the lowest price feedstock for refined products in the country will lead us to higher sustained earnings levels over time.

And with that, let me turn it over to George Damiris, our Chief Operating Officer.

George J. Damiris

Chief Operating Officer & Executive Vice President

Thanks, Mike. Third quarter crude throughput was approximately 410,000 barrels per day versus our guidance of 405,000 barrels a day. We ran 25% sour and 15% WCS and black wax crude. Our average laid-in crude cost was \$3.21 per barrel under WTI. Total refinery operating costs for the quarter were \$255 million. Operating costs were higher as a result of higher maintenance-related costs.

In the Rockies crude throughput was 59,000 barrels a day. We ran 2% sour, 41% WCS and black wax crude. Average laid-in crude cost was \$8.49 per barrel under WTI. Refinery operating costs were \$10 per throughput barrel. We trimmed crude rates and product inventory at the Cheyenne refinery in the quarter due to a temporary shutdown [ph] on the Jones (08:20) Rocky Mountain Pipeline in August limiting our access to the Denver market. We have reversed this inventory build in fourth quarter.

For the Mid-Con region, crude throughput was 252,000 barrels a day. We ran 10% sour and 15% WCS crude. Average laid-in crude cost was \$1.42 per barrel under WTI. Refinery operating costs were \$5.36 per throughput barrel.

Total lube sales in the third quarter were approximately 10,700 barrels a day with an average frac of \$70 per barrel. We were able to take advantage of the sharp reversal in Group III margins in August by running more crudes than originally planned. We are completing our El Dorado turnaround work on the go finer, FCC and alky unit, which began in late September. For the South West region, crude throughput was 98,000 barrels a day. We ran 100% Permian crude, of which 76% was sour. Our average laid-in crude cost was \$4.61 per barrel under WTI. Refinery operating costs were \$5.34 per throughput barrel. We began our planned turnaround on the hydrocracker in late September.

Total lost opportunity in the quarter was \$58 million, primarily at Cheyenne due to distillate hydrotreater outage, which limited crude rate and at El Dorado due to a hydrogen plant outage. For the fourth quarter, we expect to run 375,000 barrels a day of crude with 32% of distillate being sour and 12% WCS and black wax crude.

In addition to completing our El Dorado turnaround work, we also completed our turnaround work at the Navajo Refinery. Our remaining turnaround activity in the quarter includes work on the Woods Cross reformer and distillate hydrotreater and the Tulsa West crude unit in November.

With that, I'll turn it over to Doug for some closing remarks.

Douglas S. Aron

Chief Financial Officer & Executive Vice President

Thank you, George. For the third quarter of 2014 cash flow provided by operations totaled \$84 million or \$253 million if you exclude the effects of working capital. Third quarter capital expenditures totaled \$101 million, which excludes HEP's \$23 million capital spend.

Turnaround spending in the quarter totaled \$23 million. We are raising our full-year turnaround spending slightly to guide from \$77 million to approximately \$90 million due to turnaround work planned at our Tulsa and Woods Cross refineries in the fourth quarter. We maintain our full-year 2014 CapEx guidance of approximately \$400 million.

As of September 30, our total cash and marketable securities balance stood at \$1.5 billion, a \$300 million reduction from June 30. We announced and paid \$0.32 regular and \$0.50 special dividends in the third quarter, distributing \$163 million to shareholders. Also, our board of directors authorized a \$500 million share repurchase program in September replacing all existing share repurchase authorizations. We have purchased 2.8 million shares at an average price of \$47 since June 30. And currently have \$447 million remaining on our share repurchase authorization.

Since our July 2011 merger, HollyFrontier has returned \$2.5 billion in capital to shareholders through regular dividends, special dividends and share repurchases. Our trailing 12-month cash dividend yield stands at 7.2%, relative to yesterday's closing price of \$45.21.

Holly's debt totaled \$188 million excluding nonrecourse HEP debt of \$851 million. On July 1 of this year, we terminated our \$1 billion senior secured credit agreement and replaced it with the new \$1 billion senior unsecured revolving credit facility which matures in July of 2019. It brings us in line with standard for investment-grade rated companies and will save us approximately \$1.7 million a year while also giving us additional flexibility.

HollyFrontier owns 39% of Holly Energy Partners, 22.4 million common units plus our 2% general partner interest. The current market value of our LP units is approximately \$708 million as of last night's closing price. Third quarter general partner incentive distributions were \$8.5 million and through the first nine months of the year we've received approximately \$60 million in cash distributions from ATP.

Lastly, a reminder that you can find monthly WTI based 3-2-1 indicators for our Mid-Con, Rockies and Southwest regions posted on HollyFrontier's Investor webpage. These regional indicators do not reflect actual sales data or are meant to show monthly trends. Realized gross margins per barrel may differ from indicators for a variety of reasons.

And with that, Beth, I think we're ready to open the floor to questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Thank you. Our first question is coming from the line of Doug Leggate, Bank of America. Your line is open.

Doug Leggate

Bank of America Merrill Lynch

Q

Good morning everybody. And welcome, George. Looking forward to working with you.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Thanks.

Doug Leggate

Bank of America Merrill Lynch

Q

Okay my two questions if I may. I guess, Mike, in prior years coming into this time of year you've kind of signaled that the ramp-up in – or the increase in supply of gasoline in the Gulf Coast had sometimes been problematic to your markets. But at the same time you've made a pretty good effort of moving gasoline out of your markets and to alleviate some of that bottleneck. So I wonder if you could just give us a prognosis as to how you see things looking for your backyard as you move through into the fourth and first quarter? And I've got a follow-up please.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Sure, Doug. The inland states tend to have a greater drop-off in demand due to weather in the winter months and for that reason tend to get long in gasoline in particular. What we've done over the last couple years in anticipation of that is to expand our market footprints into surrounding states and now capable to place 20,000, 25,000 barrels a day of product into markets not previously served. And so we think that that reduces our dependence on bulk sales within the Mid-Con and will position us better as we go through these slower demand periods.

Doug Leggate

Bank of America Merrill Lynch

Q

Okay. I appreciate that. I guess an unrelated question, Mike, is probably also for you. But earlier this year you got more involved in what was happening down at HEP. And I'm just curious as to now that you see the strategies of some of your peers expand beyond what you could call the traditional refining businesses to drive growth, what are your latest thoughts on the options for maximizing the value of your own feed? And I'll leave it at that. Thank you.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Certainly. We're hitting that in two particular areas. Though the first is attempting to grow our Southeast New Mexico and Permian Basin based crude business, most recently through the Malaga gathering system expansion. We're running about 25,000 barrels a day of new gathering through that system. And it was brought on stream finally just in September. So that's been a great win for HEP, and we'll be looking to extend that in that same Delaware Basin area.

Beyond that HEP will continue to work with HFC, particularly around our growth projects, the largest of which rely on that Uinta crude and expansion of our Salt Lake City or Woods Cross refining facility. But the point there is one of building very new competent refining capacity that has high margin potential. And being able to work with HEP on a logistics related assets to participate in some of that. And we see that as a great strategy to help drive their growth and also realize better value for the margin that we're going to create out in Woods Cross.

Doug Leggate

Bank of America Merrill Lynch

Q

But, Mike, that's very directly related to your existing business. I guess not to push you too much on this, but is acquisitions outside of your traditional assets, for example as we saw with [ph] Tessaro (17:27) getting involved in gas gathering for example, is that the kind of thing that you would anticipate HEP could do in its own right? Or is it going to stay very much a facilitator for the refining? And I will leave it there. Thank you.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Sure. Doug, we participate in any and all of these auctions that we see a strategic for HEP, but we tend not to build those into our growth plans. We want to find acquisitions where we can add value. And so when we find the one that's going to work for us from a value perspective we'll chase it hard. To date we have not found one.

Doug Leggate

Bank of America Merrill Lynch

Q

I appreciate that. Thanks, Mike.

Operator: Your next question comes from the line of Paul Sankey, Wolfe Research. Your line is open.

Paul I. Sankey

Wolfe Research LLC

Q

Hi, guys.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Hi, Paul.

Paul I. Sankey

Wolfe Research LLC

Q

The traditional question about M&A and what you're seeing in that market if I could? And then the follow-up is also the usual question on demand and how things are? I think the latter one is perhaps you can probably say more about it. And it does seem that we've got more demand strength out there. And I just wondered if that was what people perceive? And I wanted to start with your perspective. Thanks.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Well it is. I'm going to let George answer the latter question on demand. And unfortunately I'm going to give a very traditional answer to the M&A question. Obviously there are a few assets out in the market right now, some

of which have very complementary location to our existing business. We desire to grow the company. We think that there's value in what is available for sale, but I'm not going to go further than that. And George, on-demand?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yeah. On the demand side, I think things are strong, especially on the distillate side of the barrel, where I think we have record crops being harvested right now. So a lot of distillate demand and good diesel cracks as a result of that.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

And beyond that the economy is stronger than I think a lot of people give it credit for. Gasoline demand through the summer sets a near-term records and then we've found demand in our core markets to be pretty robust.

Paul I. Sankey

Wolfe Research LLC

Q

Finally, Keystone Pipeline, if that was approved, what does it mean for you guys? And I will leave it there. Thanks, guys.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Keystone will be a net positive, we believe, to help rebalance Cushing to historical levels, especially bringing heavy Canadian crude down for our El Dorado refinery.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Operator?

Operator: Your next question comes from the line of Roger Read, Wells Fargo. Your line is open.

Roger D. Read

Wells Fargo Securities LLC

Q

Hi. Good morning.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Hello, Roger.

Roger D. Read

Wells Fargo Securities LLC

Q

Sounds like most of the operational stuff has been at least reasonably covered. So, I'm going to turn to the share repurchase program and the special dividend. And I was just curious understand going to a larger declared share repurchase program, but something even bigger maybe scale back on the special dividend. Historically, you've talked about increasing the regular and then maybe lowering the special and keeping the overall payout, instead you've generally raised the regular and capped the special. And I was just wondering, how you all evaluate special dividend versus larger share repurchase program?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

To-date, we're doing both in a material way and I think we have the capacity to do both. Our repurchase program traditionally is geared toward trying to find a discount to what we thought the fundamental value of the company was and it was construed as opportunistic to the Street. We have taken perhaps a more conventional approach to that, more recently. We announced the \$500 million program and we're executing on it much more regularly than we have in the past. So, I guess, I would say that to me is a substantial program and we have a track record of putting a program out there and completing it. So, we're not limited in terms of balance sheet at this point, and I think our board of directors is very receptive to putting cash to work for benefit of shareholders, be it through dividends or share repurchase. So, for the time being, we anticipate maintaining both, but extenuating the share repurchase more than we have, certainly through the first nine months.

Roger D. Read

Wells Fargo Securities LLC

Q

Okay. And then, alongside the capital allocation question, you obviously highlighted some things you can do with HEP, which I guess, to some extent, it could even fund. But are there any particular projects on the wish-list here in the refining space that from a return criteria might look find, but from a valuation relative to share repos may not have quite as good a returns that we should be watching going forward? And I'm thinking along the lines of Keystone XL came through, would there be some upgrades or expansion projects you'd like to pursue?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

Yeah. Our highest value growth right now really is in Woods Cross and focus on the local crudes produced out there. That is a big capital spend for our company with Phase 1 at \$350 million to \$400 million and due to complete here in the fourth quarter of 2015. Phase 2, we are flanging up right now have not yet approved the project but it's very attractive, though high capital cost. We see HEP participation in those projects as a great way to help both fund the project and provide growth to the MLP. So, I think we've got a good slate of executable growth ahead of us that importantly is not predicated on the growth in U.S. gasoline demand. What we are really focused on working on local crude supply and producing high-value products, particularly in the lubes sector in order to generate the bulk of this return.

Roger D. Read

Wells Fargo Securities LLC

Q

Okay. Well, that's my two. Thank you.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Thanks, Roger.

Operator: Your next question comes from the line of Brad Heffern, RBC Capital Markets. Your line is open.

Brad Heffern

RBC Capital Markets LLC

Q

Good morning, everyone. Maybe just following up on last question slightly on Woods Cross Phase 2, what's going to make the decision there, is it simply looking at what the engineering costs are going to be, or is there something

else you need to see like growth out of the Uinta or maybe how product is going into the Las Vegas market before you make that decision?

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Well, certainly the markets for the products are important as with crude supply. I mean, the decision is made as a commercial package. Right now, we are focused on getting the project cost estimation and engineering completed to a point that we have good faith in what it will cost execute it, but our commercial efforts are ongoing. So, I'd say it is a package deal. And we hope to have a quality conversation with our board in the first quarter or second quarter of 2015 on that project.

Brad Heffern

RBC Capital Markets LLC

Q

Okay. Perfect. And then just thinking about leverage levels long-term, I think you can make the argument that the company is a little bit underlevered at this point. Is there a reason that you guys would think about changing that or do you want to keep the balance sheet relatively clean maybe to accommodate an acquisition?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yeah. We don't warehouse capital in anticipation of an acquisition. We had a strategy of trying to payout steady returns to our shareholders as opposed to, sort of a one fell scoop type distribution. That resulted in industry-leading yields on our stock in terms of the dividends we payout. We also are stepping up our share repurchase activity. I think long-term to directly answer your question, our target is sort of one turn of debt relative to company EBITDA, so we have quite a ways to go in terms of getting to that point. And we will continue both with share repurchase, dividending and also and importantly growth spending because we've got quite a bit of that going on, particularly as far as Phase 2 is approved.

Brad Heffern

RBC Capital Markets LLC

Q

Great. Thank you.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yep.

Operator: Your next question comes from the line of Evan Calio, Morgan Stanley. Your line is open.

Evan Calio

Morgan Stanley & Co. LLC

Q

Hi. Good morning guys. And welcome, George. I had a different strategic follow-up question on refining M&A and you guys have historically made very accretive investments. I mean, generally I know you look at it 2x your cost of capital as your hurdle rate. But, can you maybe talk about how you account that for an uplift at AGP or what anything could have – impact could be on your GP interest in that analysis as well as when you look to normal return, I mean, how are you thinking about differentials given some of the policy flux?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yeah. Let me try to clarify 2x our cost of capital. I think what we've said is we attempt to double our money. We want to see our way to doubling our money on that which we buy.

That can come through a lot of different mechanisms. One would be a different margin assumption than somebody else might use. Another could be a different source of capital, be it HEP or otherwise, MLP capital. Growth projects within the purchased asset, consolidation in synergies as we did with the Tulsa refineries and ultimately with Tulsa and El Dorado.

So the doubling of our money is not just applying a 25% discount rate to a cash flow stream. Rather it's about what can we do incrementally through time to make money on what we buy, so that we can generate strong returns for our shareholders. And clearly in this environment the MLP is a critical tool in trying to do that, given the multiple discrepancy between C-Corp refining cash flow and that which would fit an MLP.

Evan Calio

Morgan Stanley & Co. LLC

Q

Okay. And that's helpful. And doubling in what kind of timeframe? Is it a hard stop? Or is it just over a longer period of time?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

That's where the magic is.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

I don't think that we've been that specific. But we all have reasonable expectations that this isn't going to take 20 years, right? So I think probably three years to five years would be a reasonable expectation.

Evan Calio

Morgan Stanley & Co. LLC

Q

Right. And then maybe to the differential piece. I mean just kind of given we've come through a kind of unique period since 2011, I mean how do you – I mean do you take a conservative view on what the long term differential earnings power would be? Or how do you – when you're making a much kind of longer-term investment, how do you handle that piece of the analysis?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Certainly. Look we had a great run in 2011, 2012 related to what I'd call bottleneck differentials. We don't assume bottlenecks when we look forward. We talk about differentials as they pertain to grade differentials and transportation cost. And certainly crudes can trade inside and outside transportation cost for a period of time, but that's the median around which they should trade. And I think that's what we've seen in the past generally. So that's what we tend to use for differentials.

Obviously there's the specter of exports relative to crude, and so we have to take note of that. But generally as we look at potential markets reached by U.S. Coastal sweet barrels, there is a transportation cost involved. Okay? So

it's not as though these markets are going to be penetrated without a price concession by the producer. And we think about that as well.

Evan Calio

Morgan Stanley & Co. LLC

Q

Great. That's very helpful. Thanks guys.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yep.

Operator: Your next question comes from the line of Jeff Dietert, Simmons. Your line is open.

Jeff A. Dietert

Simmons & Co. International

Q

It's Jeff Dietert with Simmons. Good morning.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Thanks, Jeff.

Jeff A. Dietert

Simmons & Co. International

Q

With the election yesterday and a new Congress in, I was wondering if you could share your thoughts on crude exports and the Renewable Fuel Standard?

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Sure. You'd probably catch me ranting here, but I'll try to maintain. So the RFS in particular, Jeff, I mean that's something that was created specifically in response to perceived threat to U.S. energy security.

I think the market has done an outstanding job of resolving that threat. And we're now pointing toward potential energy independence within three years to five years. And certainly on a continental basis we're practically there today.

So I think that mandate has far outlived its useful purpose. It's created a lot of discontinuity within the supply chain and unnecessary regulatory tension, while also taxing consumers at the pump. So I guess I can emphatically say it's broken, and it needs to be repealed. We will be working to that effect to get it repealed or at least materially changed.

The crude exports, I view that frankly as part of the same conversation. We hear a lot about how crude exports are from an era gone by. And I certainly agree with that. The 1970s and today are very different periods of time, just as 2007 and today are different periods of time.

And so I think we have to look at this as a combined whole, RFS, crude exports, even Jones Act, though that's politically a lot more intractable. These things have to be on the table if we're going to open up markets. I don't think you can singularly pull a straw from the pile and expect the pile to stay standing.

So that's what we'll work toward. We are not in opposition to crude exports. We're in opposition to lifting that ban by itself.

Jeff A. Dietert

Simmons & Co. International

Q

Thanks for your comments.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

You bet, Jeff.

Operator: Your next question comes from the line of Ryan Todd, Deutsche Bank. Your line is open.

Ryan Todd

Deutsche Bank Securities, Inc.

Q

Okay. Good morning, gentlemen, thanks. If I could start with a question on New Mexico, you referenced that the New Mexico, the crude gathering system is running, I think, up to 25,000 barrels a day at this point. Can you remind us of what the incremental cost savings on crude supply is to your refinery there in the region?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

Well, that obviously varies with the crude differential. And so, George, the third quarter Midland Cushing differential was what?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

It was about \$10 on sweet and about \$8.50 on sour.

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

Okay. So we tend to capture much of that; certainly for those barrels that are being shipped to Cushing, our gathering costs represent tariffs paid to HEP which will vary between \$0.50 and \$1 per barrel, but that's normal transportation cost. Costs another \$1 or more to get it over to Cushing. So that can give you an idea of crude economics, obviously, heavily dependent upon Midland Cushing differential.

Ryan Todd

Deutsche Bank Securities, Inc.

Q

Okay. And if we stay there on Midland diffs, I mean, can you remind us – there's been expectations for a significant narrowing of Midland diffs and obviously have narrowed some in recent months. So what are your expectations for the timing of ramping pipeline flows over the next six months out of the region and kind of long-term transport base differentials for your refinery there?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

Yeah, sure. So to our refinery there, our costs are going to represent that same \$0.50 to \$1 of gathering fee. The real question is how does Midland trade relative to Cushing or the Gulf Coast? And there is certainly a wealth of pipeline assets that have been built or being built to carry that crude to the Gulf Coast. There's also been dramatic growth year-over-year in terms of the Permian, in particular Delaware Basin which is the area that we focus on.

That growth is going to interact with crude price and the differentials likely swing around, certainly they do around any time a new line is commissioned and you have the line fill process which effectively you're buying a lot of crude to bury it back underground. Once that normalizes we see a continued mid single-digit differential between Midland and the Gulf Coast and Cushing probably sits somewhere between there.

Ryan Todd

Deutsche Bank Securities, Inc.

Q

Okay. And then maybe one last one on the Southwest, is there anything for us to be aware of. In October if we look at the HollyFrontier index, you're seeing a little bit more of a rollover in October than maybe would've expected in the Southwest, is there anything going on there that we should be aware of or is it just monthly volatility?

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Well, the Southwest is influenced by U.S. Gulf Coast and U.S. West Coast pricing. Okay? So while the Mid-Con has been pretty stout in terms of margins through October, the coastal areas have been less so, particularly for gasoline, and so the Southwest is reflecting that gasoline crack trade-off during the month of October.

Ryan Todd

Deutsche Bank Securities, Inc.

Q

Okay. Thanks. That's helpful. I'll leave it there.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Thank you.

Operator: [Operator Instructions] Your next question comes from the line of Phil Gresh, JPMorgan. Your line is open.

Phil M. Gresh

J.P. Morgan Securities LLC

Q

Hey, good morning.

Michael C. Jennings

Chairman, President & Chief Executive Officer

A

Hi, Phil.

Phil M. Gresh

J.P. Morgan Securities LLC

Q

Couple of quick follow-ups here. One is just on the buyback, obviously, you [ph] still have that premium play (36:07) in the third quarter. Just wondering if you would calibrate some of that as still being opportunistic or if this is kind of your real run rate we should be thinking about moving forward?

Douglas S. Aron

Chief Financial Officer & Executive Vice President

A

I think that it's probably some of both. We saw – buying back stock I guess taking a step back, buying back stock in a volatile industry like ours sometimes can be challenging, and I would tell you we're not perfect market timers, but when we see opportunity we tend to be more aggressive; when we see a 30-day or longer strong run in the stock price, we would tend to be less aggressive.

But I do think the announcement of that \$500 million program by the board to replace what was already existing was an indication that yes, we'll be more aggressive than we have been historically. I don't think it means that you can expect \$125 million per quarter of buybacks in every quarter, sort of no matter what. And appreciate that that's not really easy for modeling, but that's the way we tend to run it.

Phil M. Gresh

J.P. Morgan Securities LLC

Q

That's fair. I appreciate that. Second question just on Woods Cross Phase 1. I don't think you mentioned any updates on the project cost or the return expectations, just wondering where you feel those are right now. I think recently, you had raised the cost estimate, but just wondering about comfort levels on both sides of that equation?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yeah, we're good with our previous disclosures and announcements, the range that we provided is still one that we can live well within. Completion period, it looks like October, November of 2015, bringing it on stream in terms of production towards the end of the year there. And the economics remain as we've announced them previously.

Phil M. Gresh

J.P. Morgan Securities LLC

Q

Okay. Last question is just, you had mentioned you expect Brent WTI to widen, you also just made the comment in reference to the previous question about WTI to the Gulf Coast having kind of, I guess, a low single-digit differential. So I guess I should interpret that to mean that you expect Brent LLS to be the re-widen there. So I'm just kind of curious what you think will ultimately lead to that re-widening just given what we're seeing with the Brent markets recently?

George J. Damiris

Chief Operating Officer & Executive Vice President

A

It's a fair question. Obviously, there's a lot that's happened recently that has caused us to scratch our heads and question assumptions that we thought were accurate. I think what is fair to say is that through time there's a strong need on the part of the producing nations, perhaps less so in respect to Saudi Arabia, but certainly others have a fairly high marginal cost of maintaining social stability. And I think you're going to see volumetric action on the part of OPEC and others to try to sustain that.

That price in a zone that allows them to run their countries and their fiscal budgets reasonably, and there are obviously differences by country and by producing regime around cost of production and otherwise social cost. But I don't believe that price of crude in the \$70s is going to meet the bar in terms of providing that stability that

allows production to continue. So, one way or another I believe crude prices will be higher and the Brent price will be higher than U.S. Coastal prices.

Phil M. Gresh

J.P. Morgan Securities LLC

Q

Fair enough. Thanks for your thoughts.

George J. Damiris

Chief Operating Officer & Executive Vice President

A

Yeah.

Operator: There are no further questions. I will turn the floor back over to Julia Heidenreich for closing remarks.

Julia Heidenreich

Vice President-Investor Relations

Thanks everyone for joining us. If you have any follow-up questions give us a call. I'll be at my desk all day and otherwise have a great holiday season, and we look forward to sharing our full year and fourth quarter results in February.

Operator: Thank you. This concludes today's teleconference. Please disconnect your lines at this time and have a wonderful day. Thank you.

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