Corrected Transcript

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HollyFrontier Corp. (HFC)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

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

Thank you, Shannon. Good morning, everyone, and welcome to HollyFrontier Corporation's first 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 March 31, 2014. If you'd like a copy of today's press release, you can find one on our website at www.hollyfrontier.com.

Before Mike and Doug proceed with their prepared 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 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. Today's call may also include discussion of non-GAAP measures, please see the press release for reconciliations. Also, please note that information presented on today's call speaks only as of today, May 6, 2014. Any time-sensitive information provided may no longer be accurate at the time of any webcast replay or re-reading of the transcript.

With that, I'll turn the call over to Mike Jennings.

Michael C. Jennings

Chairman, President & Chief Executive Officer, HollyFrontier Corp.

Thanks, Julia. Good morning. Thank you for joining us on HollyFrontier's first quarter earnings call. Today, we reported first quarter net income attributable to HFC shareholders of $152 million or $0.76 per diluted share. Our first quarter EBITDA was $339 million, more than double, our reported fourth quarter EBITDA of $158 million. Current quarter earnings were driven by strong winter time refined product crack spreads throughout our inland system, somewhat offset by narrowing crude differentials, a decline in fuel oil and asphalt cracks and elevated RINs cost during the quarter.

First quarter crude throughput was 416,000 barrels per day versus our guidance of 410,000 barrels per day. We ran 21% sour, 20% WCS and black wax crude. Our average laid-in crude cost was $4.12 per barrel under WTI. And regionally we experienced average laid-in crude differentials under TI as follows: $11.27 under in the Rockies; $3.11 under in the Mid-Con, and $1.96 under in the Southwest. That's on a per barrel basis.

As expected, inland coastal crude differentials compressed to approximately 20% during the quarter due to new pipeline capacity from Cushing to the Gulf Coast. I continue to view this demand pull from Cushing as a temporary phenomenon and expect the Brent TI spread to widen through 2014 as production grows in the second half of the year and Northern Tier pipelines come online. We also benefit from light, heavy and sweet, sour discounts, though the Canadian crude differentials compressed approximately $10 during this quarter, driven in-part by extreme winter weather in the producing region.

The sweet-sour spread was favorable during the first quarter with WTS at Midland trading below WTI Cushing by an average of $3.60 for the quarter. This differential has recently grown to about $8 per barrel during March and April, which will contribute to an improved second quarter capture for our Southwest operations where we run on average 95,000 barrels per day of Permian crudes.

Our lost opportunity in the quarter was $46 million. The majority of which was caused by severe weather and subsequent freeze-up issues at our Cheyenne plant and also due to reduced rates at the Navajo refinery attributable to waste water treatment issues. The Navajo refinery has been operating at full rate as planned since the end of January after we installed new water processing equipment and secondary filtering technology.

Our first quarter consolidated refinery gross margin was $14.80 per produced barrel, 35% above the $10.96 of gross margin that we recorded in the fourth quarter of 2013. On average through the quarter, Mid-Continent gasoline priced at approximately $0.15 a gallon over Gulf Coast gasoline 85 octane.

I expect continued volatility in this pricing relationship, given high utilization rates across the North American refining system, but I believe that our inland markets will show improvement as we move into driving season and springtime agricultural activities that spur diesel demand.

Offsetting the improvement in indicator margins was a negative capture impact from weaker co-product prices following the run up of WTI during the first part of the quarter. The Rockies was most affected having an 8% combined asphalt and fuel oil yield. In the Rockies negative $12 and negative $29 WTI based fuel oil and asphalt cracks reduced actual capture by about $3.50 per barrel versus our Rockies 3-2-1 indicator margin.

The second quarter is off to a strong start. Our plans are running well and our product margins are strong. April indicator margins for all regions were 5% to 15% above first quarter average levels and so far in May we're seeing $15 to $20 gasoline crack and $20 to $30 diesel cracks across our market.

For the second quarter of 2014 we expect to run 425,000 barrels a day of crude with 23% of the slate being price advantaged heavy crudes, 21% sour crudes.

Our second quarter crude charge estimate is affected by reduced crude rate at the El Dorado refinery at the end of April following an external power failure. Overall, we see the current market structure as constructive with employment and economic activity growing and U.S. petroleum product demand and product inventory levels supporting stronger refining margins. Crude production growth domestically is being driven by high levels of drilling and development in the lower 48 states and we expect this production to progressively displace higher costs imported crude oil at U.S. refineries providing favorable crude differentials for the refining industry.

Looking forward in the current year, our internal plans include high expected capacity utilization in the second and third quarters and a fourth quarter FCC, gofiner and Alky unit turnaround at El Dorado, as well as the Artesia crude unit distillate hydrotreater and gas/oil hydrocracker all at the Navajo refinery.

With that, I'll turn it over to Doug Aron, our Chief Financial Officer.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Thank you, Mike. For the first quarter of 2014, cash flow provided by operations totaled $395 million. First quarter capital expenditures totaled $103 million excluding HEP's $21 million capital spend. Turnaround spending in the quarter totaled $4.3 million. We maintain our full year 2014 CapEx guidance of $400 million and turnaround spending of $77 million. Total refinery operating cost for the quarter were $239 million. We spent nearly $20 million more than the previous guidance on natural gas in the quarter, driven by a combination of both higher price and volumes attributed to the extreme weather.

As of March 31, 2014, our total cash and marketable securities balance stood at $1.8 billion versus $1.7 billion on December 31 of last year. HollyFrontier debt totaled $189 million, which excludes non-recourse HEP debt of $834 million. In March, HEP redeemed its $150 million 8.25% senior notes and incurred a $7.7 million charge associated with that redemption. Going forward, consolidated interest expense should be approximately $10 million per quarter.

In the first quarter, we announced and paid a $0.30 regular and $0.50 special dividend, distributing $159 million to shareholders. Since our July 2011 merger, HollyFrontier has returned approximately $2.1 billion in cash to shareholders through regular dividends, special dividends and share repurchases. As of March 31, we have $312 million remaining under our share repurchase authorization. As of today, our trailing 12-month cash yield stands at 6.2% relative to yesterday's closing price of $51.60.

As for an update on our hedging program, we've sold forward a total of about 35,500 barrels of diesel for calendar 2014 at an average price of $28.62 a barrel. We've sold 36,000 barrels of gasoline at an average price of a little more than $12 a barrel. And for 2015, we've sold 12,000 barrels a day of diesel at an average crack spread of $30 a barrel and about 4,000 barrels of gasoline for the current quarter, that being May and June timeframe at about $18 a barrel.

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 web page. These regional indicators do not reflect actual sales data and are meant to show monthly trends. Realized gross margin per barrel may differ from indicators for a v ariety of reasons. You can find the data on our investor page at hollyfrontier.com.

And with that, Shannon, I believe, we're ready to take questions. Operator, are you there?

QUESTION AND ANSWER SECTION

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

Doug Leggate
Analyst, Bank of America Merrill Lynch
Q

Thanks. Good morning, fellas. I wonder if I could ask you to talk a little bit about the operating performance, because obviously compared to last year significantly better. And I just wonder if you could provide some confidence I guess or some guidance as to what's changed and why you're confident you can basically maintain this performance through the, I guess, the peak season. And I've got a follow-up, please.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Yeah. Doug, reliability is something that's getting a ton of focus inside this company. I won't say that we've achieved what we want to yet, but we're improving pretty progressively. Take Navajo as an example. We solved that waste water problem in the month of December and got through it, by about the 20th of January and have been running full ever since. Cheyenne was actually having a quite good quarter and got tagged with a severe freeze-up in which they lost their steam system. But, I guess, to answer your question succinctly, a ton of focus and some amount of investment, and we do have confidence that we can move the needle through the remainder of the year as we look forward.

Doug Leggate
Analyst, Bank of America Merrill Lynch
Q

Okay, I appreciate that. My follow-up is really, in the past, Mike, you've talked about efforts to try and move product out of your region. I guess that's going to be less of an issue during the summer months, but can you just give us an update as to how that process or what your thought process is as to how you might achieve that? And perhaps, just underline again whether you still see the kind of volatility in your region as a result of, for want of a better expression, Gulf Coast gasoline making its way into your markets. And I'll leave it there, thanks.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yeah. Sure. The issue really is one of how much demand is there to absorb full running Mid-Continent refining system. And I think from a system perspective,

the obvious markets are to the south and to the east. Our company is pursuing that strategy. I wouldn't tell you that we expect a physical link to the Gulf Coast anytime soon, but we also don't believe that we need that. As we look to markets traditionally served by Gulf Coast refiners we feel like we can compete in those, particularly North Texas, states to the east of our markets currently that we don't serve. So that's really our focus area.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

So is it fair to say, Mike, are you seeing any kind of regional tightening in your markets as a result of these efforts? I mean, you are only one refiner obviously but are others pursuing the same kind of issues or just – what's your overall prognosis for the market I guess as you go forward?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yeah, well if you contrast the current winter to that of 2011 when the Magellan system was really full and apportioned, I think we are seeing progress. And as you know, petroleum barrels move incrementally. So I don't know that I can tell you number of barrels into which new markets by which particular producer but I can compare year-over-year performance within the Magellan system in particular and product is moving out to other markets.

Doug Leggate
Analyst, Bank of America Merrill Lynch

Q

That's really helpful. Thanks guys.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yep.

Operator: Your next question comes from the line of Paul Cheng of Barclays. Your line is now open.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

Hey, good morning guys.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Hi Paul.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

Mike, can you remind me for Navajo the oil that you received from Permian, do you receive it just from the common carrier or that you have your own gathering system?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

No, we have a significant gathering system owned by our MLP Holly Energy Partners which delivers roughly 50,000 barrels a day to the Navajo refining system.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

And with the – there is, I think, increasing campaign from some of your peer that the oil quality [ph] people is (15:27) increasingly and certainly more and more condensate and all that. So it seems to have a significant advantage that having your own crude gathering system trying to supply to 100% of your refinery.

Is that something that you guys going to step up and be more aggressive in investing on the HEP side so that you can get the entire 90,000 barrels per day to 100,000 barrels per day of Navajo [ph] condensate (15:54) coming from your own gathering system?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Right, Paul. We are doing exactly that. HEP has announced an expansion of that gathering system, which they dubbed the Malaga project. Initial opportunity there is an incremental 40,000 barrels per day or so and expandable to 60,000 barrels per day.

So, at that point, we would be gathering in excess of our own demand. But you highlight an important advantage, and that is to be able to control the barrel coming into your refinery and having these more captive gathering systems does permit that.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

Can you share with us that comparing to your own gathering oil to those that currently you received from the third-party, what kind of incremental benefit that we may be talking about, and also what kind of timeframe do you think you will get to a point you actually would be 100% supply your own?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yeah. The ability to supply our own is just going to hinge a bit on production growth, but we do see that in the Delaware Basin. As to crude quality versus crude price, I'm going to take a pass on that, Paul, for competitive reasons. But I would tell you that it's meaningfully better.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

Should we assume over the next 18 months, you would get to 100%?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

I believe so, yes.

Paul Cheng
Analyst, Barclays Capital, Inc.
Q

Perfect. Thank you.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yeah.

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

Paul I. Sankey
Analyst, Wolfe Research LLC
Q

Good morning, all.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Hi Paul.

Paul I. Sankey
Analyst, Wolfe Research LLC
Q

Hey, guys. I'm sure there's a conference call [ph] jerk (17:29) in here somewhere, Doug, but I'll just move on to my question.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

How did you get this number, operator?

Paul I. Sankey
Analyst, Wolfe Research LLC
Q

Can you just dig back into the operation. I think the major concern we have is the operational performance question, Mike. Can you just do a look back, was it a high level of turnaround last year, what were the issues last year? And you've kind of stated that it's going to be better this year, but can you just talk more about your confidence and why? Thanks.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yeah, there are really two things. One is less planned maintenance and fewer units at end of cycle, which we had a lot of last year across our systems, so between sort of sliding into turnaround and then needing to come out of turnaround that certainly affected performance. And then I've got to say that it's just old fashioned blocking and tackling Paul. And as I expressed previously, we haven't solved all the problems that we want to, but we are getting better in terms of reliability and finding main culprits and knocking those off one at a time. So I am confident that we will improve certainly year-over-year and move closer to our targets.

Paul I. Sankey
Analyst, Wolfe Research LLC

Q

And to the extent you're prepared to, can you talk a bit more about how much turnaround and maintenance you're going to have this year coming?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Sure. I specified earlier on, but our turnaround activities include our all compressions in fourth quarter, the Navajo refinery, Artesia New Mexico has small crude unit that's being turned around as well as a distillate hydrotreater and mild hydrocracker, so hydrotreating units. The El Dorado refinery at a similar time in October time period will be turning around its cat cracker gas-oil hydrotreater and alkylation unit. So [ph] big (19:15) units, but fairly modest across relative to our entire system.

Paul I. Sankey
Analyst, Wolfe Research LLC

Q

Great. And then finally from me, Mike, you've often expressed views on the crude market and the way things are moving in the U.S. What's surprising you about the current market and what's your outlook for the next year or so? Thanks a lot.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Sure. I think there isn't a lot of surprise. A lot of pipeline capacity was built and subscribed for to connect Cushing to the Gulf Coast and crude hasn't yet filled it. And so that those prices between Houston and Cushing are trading very similarly right now, separated by maybe $0.50 if you adjust for crude quality.

Through time I believe those differentials will re-widen as we get more Northern Tier pipelines from North Dakota, as an example, potentially from Canada connected up to Cushing. Beyond that, I think the obvious is kind of a comment around crude production growth and the likelihood that the Gulf Coast crude separates from Brent further as time goes forward due to additional production domestically.

Paul I. Sankey
Analyst, Wolfe Research LLC

Q

Thank you. Thanks a lot.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yes.

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

Jeff A. Dietert
Analyst, Simmons & Co. International

Q

Good morning.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Hi, Jeff.

Jeff A. Dietert
Analyst, Simmons & Co. International
Q

I was hoping you could talk a little bit about the HEP New Mexico gathering system, what types of quality of crude are you expecting. Is it lighter API gravity crude and other unique design or processing capabilities that are associated with this system?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes, so our targeted area is in the Delaware Basin extending south from our refinery and then east from there. And we have seen lighter crudes coming. We believe that we've designed for that. As it extends further south yet, the crude starts to heavy up. So I don't believe that we're going to have problems in terms of crude gravity that are going to affect our own gathering capabilities or refining capabilities. With that said, there probably is a blending opportunity for the incremental barrel that we might sell into the market, because it is a very light and sweet crude.

Jeff A. Dietert
Analyst, Simmons & Co. International
Q

Given the substantial growth that's expected out of the Permian and kind of uncertainty as to quality until we see more production, are there potential projects at Navajo for expansion of like crude capabilities there?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes, we expect to be running more light crude at Navajo and obviously that puts pressure on light ends processing and naphtha treating portion of the refinery. And we'll advance that progressively as we need to. For the time being we feel like the kid is in pretty good shape as compared to the crude slate. So I don't think that we need a lot in terms of projects. There's obviously the potential to do some condensate splitting out in the Permian, and the challenge is simply one of what to do with the condensate and can you transport it cost effectively to the Gulf Coast which would be the market point for that, and that's something that we're considering but haven't cracked the code yet.

Jeff A. Dietert
Analyst, Simmons & Co. International
Q

Got you. It seems like there's a substantial race between production growth and pipeline capacity additions with BridgeTex coming on next quarter and then Cactus and Permian Express. Could you talk a little bit about what your expectations are for WTI Midland differentials relative to Cushing over the next 12 months or so? And I'll leave it there. Thank you.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Sure. I think that the production growth in the Permian – the big basins are obviously the Bakken, the Permian and the Eagle Ford. And the level of activity in the Permian, in our view, will fill incremental pipelines that are planned.

So we don't expect to see the current wide differentials persist through 12 calendar months. But I think that's going to be the pattern is that production will grow a little more quickly than the infrastructure will facilitate.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Jeff, the only thing I'd add to that is that with BridgeTex and others coming online at some point, I think, maybe not conventional wisdom, but certainly some of us out there question at what point does the Gulf Coast become saturated? And if we continue to see the Gulf Coast trade at effectively parity to Cushing, are folks willing to spend $3, $4, $5 a barrel shipping to the Gulf Coast to get the same or in some cases a lower netback?

And in Mike's opening comments, he talked about us viewing the likelihood of that widening back out as you see more crude come from the north. And I think that's certainly a strong possibility that we could see by mid-third-quarter anyway.

Jeff A. Dietert
Analyst, Simmons & Co. International
Q

Very good. Thanks, guys.

Operator: Your next question comes from the line of Ed Westlake of Credit Suisse. Your line is now open.

Ed G. Westlake
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Yes. Thank you, and thanks for the color on Navajo in terms of gathering some of the local barrels. Just remind us as you look at the Cushing system, say, Tulsa, are you able to get Permian barrels in the Midland, source them there, and then just pay the freight to get it over to your refineries. Any volumes there that sort of should be advantaged in Q2 that we should be aware of?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

We don't have advantaged transportation or subscribed transportation from Midland to Cushing, so in the Mid-Con we're effectively paying Cushing price.

Ed G. Westlake
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. That's helpful. And then the cash flow, Doug, was very strong in the quarter. Was there anything in the working capital that contributed to that strong cash flow? Obviously it's great to see the EBITDA improve sequentially as well.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

There was. What we had was about a $150 million benefit from change in working capital in the period; $35 million or so of that was payables increasing ahead of inventories, and then the other big item was an income tax receivable of about $97 million providing working capital in the period.

Ed G. Westlake
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Okay. Thanks very much. And then just obviously a lot of people focus on [ph] bps (26:08) and everything, but maybe any update on the self-help in terms of where we are at the Tulsa refinery, if there's anything more still to come?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes, we are knocking things off small project by small project and we're improving the liquid yields within that system. I don't think that there is anything headline making with respect to Tulsa. Our significant growth projects remain the Woods Cross expansion project as well as the El Dorado naphtha splitter. But I do think that you will see more in Tulsa in terms of reliability and margin capture as we go forward just with our small capital program.

Ed G. Westlake
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

And now that you've mentioned it, are those – the Wood Cross is still on track?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes.

Ed G. Westlake
Analyst, Credit Suisse Securities (USA) LLC (Broker)
Q

Great. Thanks very much.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Thank you.

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

Evan Calio
Analyst, Morgan Stanley & Co. LLC
Q

Hey, good morning, guys. Like all places, the focus is on the Permian and your color around Navajo is helpful. Let me switch gears on Woods Cross Phase II. I know Group III lubes market is a little bit less transparent, at least to us. Do the recent capacity expansions at Baytown and Chevron's Pascagoula for lubes alter your medium-term outlook? I presume not, but listen to your thoughts. And then also, now that you have your permits, is the CSA still the gating item? Any update there?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes. So with respect to the market for the Group III lubricants product, obviously, a lot of capacity has come on recently that's Group II capacity and has affected the market price of the crack spread for base oils. Certainly, that affects our short-term view, but we're looking a little farther out than that and we have to, because the demand for

Group III oils is both as a correcting or an improvement fluid for Group II and a base oil on to itself in terms of unique spec.

So, I don't think we're go or no-go on account of new Group II capacity being brought on stream at Baytown and Pascagoula. More broadly, is the gating item the economic analysis and the cost analysis? Yes, absolutely, and we're probably six to 12 months from really having a clear understanding of what the project could cost and what the economic returns might be. So, in addition to that, as you speak, the crude supply remains out there and we don't have the barrels to charge that plant yet. So there's work to be done, but we're still optimistic that it makes a lot of sense, and it would fit very well with our Woods Cross processing scheme.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

Great. Thanks and a second question, Cushing has been drawing for the past six to seven weeks. Where do you guys have a view on where minimum level of inventory is at Cushing, and I know while you expect Brent-TI to widen in 2014, moving up from the Gulf, do you see any differential risk in the near term as we move away from tank tops and looking for tank bottoms here?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Well, I don't [ph] own a tank bottom (29:31) in Cushing nor does HollyFrontier. We read in the press that working inventories might be 20 million barrels and we're at 26 million barrels or so right now. Is there a chance that Cushing trades at a premium to the Gulf Coast? I really don't think so. More aptly, will we test the 20 million barrels of bottoms, it's really hard to say.

I think you need to look at the accumulation of sweet crude in tanks on the Gulf Coast and ask who is going to run that barrel and who is going to continue to buy the sweet barrel and ship it down. As you know, the market structure is currently backwards, which means that anybody storing crude in tanks is paying $0.75 to $1 per month in addition to storage costs via the market structure. So I don't think that we've necessarily reached a bottom in terms of Cushing inventories, but there's certainly an economic cost and the benefit of pushing more sweet crude to the Gulf is not clear to me.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

And you talked about it a little bit in your prior comments, but any other discussion on the organic growth opportunity at the HEP level, given it's in your backyard at Navajo on the collection and gathering side? I'll leave it at that. Thanks.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Yes, sure. Evan, I think, Mike enumerated the Malaga project, which is going on. We've got a truck dock expansion in Las Vegas, which is some additional incremental EBITDA for HEP that we would expect here in the next 90 days. We're also looking potentially in, what I'll call, generically, the Rockies, so Niobrara and Uinta Basin, for some opportunities to grow our infrastructure.

And then we're also looking at third-party acquisitions and haven't had anything to report there. I think that market was very frothy last year and continues to be hot and competitive. But we're still looking and, particularly, for things that are in our backyard and around the basins that our refineries serve, because that's the most logical area for us to do it.

Evan Calio
Analyst, Morgan Stanley & Co. LLC

Q

Good. Maybe, the key new members to your team can help that. Appreciate it.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Thanks, Evan.

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

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Hi. Good morning.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Hello, Roger.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

I guess I'd like to come back to a couple of maybe a little more operational issues. You mentioned the impact of higher natural gas taking numbers from a year ago and looking at the change in Q2. Would we be looking at natural gas impacts of about $45 million to $50 million higher Q2 this year versus a year ago using kind of a $1 – call it, a $1.20 difference in the average price?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

I think that's right. I'm not sure I completely followed your math, but I'm showing on an annual basis these days about every dollar change is about $41 million pre-tax for us. So quarterly about $10.25 million or so. I'm sorry, go ahead.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

I was going to say, a year ago you said $0.70 in difference in price was about $28 million, so I'm just kind of extrapolating off of that and then what you had had in the commentary.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Yes, so I'd say quarterly every dollar change is about $10.25 million. And I don't know exactly what nat gas price was in Q2 of last year. But I think if you just use an annual sensitive of $41 million for every dollar change, you probably can get there.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Okay. Completely unrelated, any update on the Tier 3 impacts in terms of estimated cost kind of compliance programs you're going to have to put in?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yes. We're still evaluating the projects that we will need at our various locations, and then we will be spending some amount of capital, but we really don't have a number ready to share, and we're looking for solutions that don't deploy significant capital.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Okay. Any idea where the...

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Yes.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Yes.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Yes. I want to add to that final answer that our natural gas sensitivity is on an unhedged basis, so we have hedged about 25% of our usage, so after taking that hedge into consideration, the sensitivity for every dollar change is about $32 million on an annual basis.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Okay. Thanks. That's helpful. And then, back to the Tier 3 as sort of a follow-up there, if you could help us remember, which facilities are the ones that are going to probably have the biggest challenges catching up with the new gasoline regs?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Right. So Cheyenne probably has the largest individual challenge, but its compliance date is 2020. Woods Cross, I think, very sweet crude has the least challenge, but again it is 2020. So that leaves Navajo, El Dorado, and Tulsa at 2017 and they are pretty similar, with El Dorado probably having the greatest need for investment because it runs the heaviest crude, the sourest crude.

Roger D. Read
Analyst, Wells Fargo Securities LLC

Q

Okay. And then, my last question and I was looking through my notes, so I apologize if I didn't find the exact right spot, but a year or so ago one of the discussions was being able to add some pipeline tie-ins to bring more WCS into your plants, but that was obviously going to be offset by you don't want to produce more asphalt.

Just wondering if you could update us maybe your thoughts on doing something along that line, what the permitting process may be or maybe you're already into that, and whether or not that's even something you're still considering or still pursuing.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes. Right now it's not something we're pursuing. The limitation is in the northern tier transmission capacity, I'll call it the mainline system of Enbridge or capacity available within Keystone. So there are some things that we can do when new pipeline capacity is built. And we may choose to tie into Pony Express which is not a heavy crude pipeline, but one that transmits Bakken down to the Mid-Con. But in terms of heavy barrels, we don't see that opportunity right now.

Roger D. Read
Analyst, Wells Fargo Securities LLC
Q

Okay. Thank you.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes.

Operator: Your next question comes from the line of Chi Chow of Macquarie. Your line is now open.

Chi Chow
Analyst, Macquarie Capital (USA), Inc.
Q

Thank you. Doug, I want to ask about the dividend policy. You've kept a special dividend now at $0.50 for almost three years running. I guess that's excluding one quarter in 2012 where you doled out two of them. But can we expect that to stay constant going forward or do you have any thought on varying the special and/or thoughts about the split between the regular and the special?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Chi, I think that you've basically got it right, and I think what we said on our last conference call and certainly haven't had any change since then is that the regular dividend is one that we would expect to grow steadily over time, and I think it's been almost now 12 calendar months since our last increase there. We'll see our board next week and have that discussion certainly as we do every quarter.

And on the special, I think the different twist that we gave perhaps on the last call was that we may see a bit more variability in that over time, perhaps paying out more when we earn more and less when we earn less. But the caveat that with a $1.8 billion of cash and almost no debt that you wouldn't expect us to pay less than that until our cash was more in the $1 billion or less range.

Chi Chow
Analyst, Macquarie Capital (USA), Inc.

Q

Okay, great. And then I guess on RIN purchases in the quarter, do you have something you can share with us on that cost in 1Q and what's sort of your expectations on RINs going forward here for the rest of the year?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

We'll get you the cost in a minute here. Our expectation, Chi, is that we're about 50% in need of purchasing RINs, meaning we don't blend about 50% of our overall volumes. What's the price for those RINs will be, as we go forward, is pretty opaque to me, honestly.

We've spent a lot of time and effort working in Washington and lobbying and discussing and educating and to no real avail yet. So I think the ball is in the court of the EPA in terms of the annual RVO and how they choose to moderate that in order to line up with what is really feasible within the system. But I don't think our company has unique insights on when and how they're going to do that.

Costs for the quarter, Chi, for compliance with RFS for us was about $45 million in total. Again, that's pre-tax. That number is higher than you might have expected, given the average RIN cost for the quarter, because we account for our RINs on a first-in, first-out basis. And so we had fourth quarter RINs from last year, more in that $0.80 range that were being run off for the quarter. Although we typically don't give guidance, I would tell you we'd be more in the $30 million to $35 million range for Q2 and stepping down from there, if we continue to see a decline in that RIN price.

Chi Chow
Analyst, Macquarie Capital (USA), Inc.

Q

Okay. Great. Thanks, Doug. And maybe just one more operationally. I know that op costs have been pretty high at Cheyenne due to the weather issues the last couple quarters and downtime. Any sort of guidance on Rockies, quarterly OpEx per barrel going forward here?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Chi, I would say that it ought to be back in the – more of what we saw in Q4 as guidance going forward with a big caveat of natural gas being, again, every dollar change, so a $10 million or $11 million per quarter sensitivity.

Chi Chow
Analyst, Macquarie Capital (USA), Inc.

Q

Okay, great. Thanks, Doug. Appreciate it.

Operator: Your next question comes from the line of Blake Fernandez of Howard Weil. Your line is now open.

Blake M. Fernandez
Analyst, Howard Weil, Inc.

Q

Folks, good morning. Thanks for taking the question. I had to hop on late, so I apologize if this was covered, but I'm trying to get a sense on DD&A overall on a consolidated basis. I think we were kind of in the norm of about $78 million to $80 million for 1Q. I'm just trying to get a sense if that's a good run rate moving forward for the balance of the year?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Yes. It is.

Blake M. Fernandez
Analyst, Howard Weil, Inc.
Q

Okay. Secondly, I think in the past – Chi already kind of addressed the dividend policy, but in the past, I think, you had kind of given an indication of different levels where the buyback would be maybe more aggressive. It looks like you repurchased a little bit during the quarter. Just any thoughts around what level you may be willing to set that up?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Blake, I don't think we're going to tip our hand quite that far. We've said we make share repurchases opportunistically, and other than that obviously offset any dilution from shares granted to management, our directors and opportunistically is, I guess, a secret sauce or a secret formula; like the guys at Coca-Cola, we're not going to be able to share that.

Blake M. Fernandez
Analyst, Howard Weil, Inc.
Q

Okay, fair enough, guys. The last one for you; I think, you mentioned the tight difference between crude in the Gulf Coast and WTI. We haven't had a lot of discussion on take-or-pay lately, but it kind of begs the question, is that kind of being witnessed in the market. I just didn't know if you had any thoughts on whether take-or-pay is maybe going to lead to these spreads between Gulf Coast and Cushing crudes, maybe remaining compressed for a while.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Well, Blake, there are a number of things at work right, one of which is just simply, does that barrel have a home on the Gulf Coast. But to the extent that those pipelines are subscribed on a take-or-pay basis, the transportation costs can be perceived as sunk. So then you've got to figure out is there a spot for that crude and does the crude quality that's coming in warrant bringing it to the Gulf Coast at all. And I guess, we don't have a lot of specific insight into what other market participants are doing, but I think if you just look at the indicator prices of TI Cushing versus Houston light or what they're posting now for Port Arthur, you can conclude that the full transportation cost is not reflected in the differential. And then, those things happen in this business. They tend not to persist through time, but they do happen.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

And I'd add that my understanding is that all of them have some, albeit small, but there is a variable component to shipping a barrel, even when you have a take-or-pay arrangement. So, you have to consciously decide that you're willing to spend an incremental $0.60, $0.70, $0.80 to ship a barrel that might be out of the money in the example that you're giving us, Blake.

Blake M. Fernandez
Analyst, Howard Weil, Inc.
Q

Right, right. Okay. Well, thanks for your comments. Appreciate it.

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Sure. And, Chi, as a follow-up, we gave on our last quarter $260 million quarterly as a run rate for our OpEx, so I'd use that number going forward and – again, unless there's a material change in that gas price.

Operator: Your next question comes from the line of Faisel Khan from Citigroup. Your line is now open.

Faisel H. Khan
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Thank you. Good morning. It's Faisel from Citigroup. Just had a few questions. If you could go back to some of your comments on the potential for both acquisitions and organic growth in the midstream sector and how you would use HEP? So, are you saying that the acquisition market is still pretty frothy or has the market cleared and are there more opportunities now today at the right price than there were last year?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Faisel, I think that it is a very competitive marketplace out there. You have not only the traditional MLPs but a lot of privately funded entities that are set up as midstream businesses with an expectation of going public and a strategy of growing by acquisition. So, it is still strongly competitive. The multiples that we're observing for low growth transportation assets might be, I don't know, 12 times, 13 times, 14 times cash flow, and those prices to us are pretty high unless there's a strategic driver. So, we're really focusing in our backyard with respect to our MLP and particularly increasing our capabilities and gathering system within the Permian Basin.

Faisel H. Khan
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Okay, great. And then I think you guys mentioned some of the opportunities up in the Uintah and the Rockies. I think Newfield discussed on one of their calls that they're looking for sort of a pipeline solution into Salt Lake. Is that something you would participate in? And is this related to some of the heavier crude or is this related just to light sweet crude?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Yes. That project is being discussed by some industry participants, and I'm thinking we are most likely under confidentiality around it, and so I'm not going to go further. But it's an interesting concept, because the Uintah is going to be producing probably upwards of 60,000 barrels, 70,000 barrels a day, as we look forward. And that's a lot of trucks on the road. So, a pipeline solution might make a lot of sense up there.

Faisel H. Khan
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Okay, understood. And you guys said in one of your press releases, I think, discussed your expansion of your asphalt business into the Southwest. And I think you discussed that also in the realm of leasing an asphalt terminal. Is that a business that's going to have a major contribution to the bottom line or is that just sort of expanding your reach in terms of where your product can get?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

It's really more the latter. It's a retail distribution capability within our asphalt business. And we've taken leases for two incremental terminals, which traditionally has allowed us to uplift our margins pretty substantially. And we're getting to develop a pretty nice franchise in that Southwestern asphalt business.

Faisel H. Khan
Analyst, Citigroup Global Markets Inc. (Broker)

Q

Okay, but nothing material that we should see drop down to the bottom line.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

No.

Faisel H. Khan
Analyst, Citigroup Global Markets Inc. (Broker)

Q

Okay. Thanks, I appreciate the time.

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Yes.

Operator: Your next question comes from the line of Paul Cheng of Barclays. Your line is now open.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

Hi, Mike. Now that you are – the 77% sour crude, I presume that that's WTS. What's the opportunity for you to now reduce it and replace with the light sweet?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.

A

Paul, the 77% sour is WTS and that lands at the refinery, other than in the month of February of this year it seems. But it tends to land slightly cheaper than the WTI Midland alternative. So, six or one-half dozen to the other. The important point right now is that we are buying crude on a Midland basis for that Navajo Refinery and are able to realize the benefits of being in the Permian. And whether it's the real light barrel or a WTS grade, our refinery has capacity to handle either of those, so we really shop for price.

Paul Cheng
Analyst, Barclays Capital, Inc.

Q

So, I understand, but I'm saying that from a configuration standpoint, I think there's a argument in the industry or that some view that with the increasing condensate production in the Delaware Basin that you have more and more people looking for a little bit heavier barrel [ph] to brand (48:50). And as a result, WTS may continue to trade at a premium going forward versus the Midland. And if that's the case, what I'm trying to understand is that just based on your configuration, what is the minimum that you can run in terms of WTS?

Michael C. Jennings
Chairman, President & Chief Executive Officer, HollyFrontier Corp.
A

Paul, the sours that we're running at the Navajo Refinery are a very light sour, okay. So, based upon our configuration, we probably can run mostly sweet crude out there, because the gravity is really not the issue. The sour that we're buying tips over based upon sulfur content. It's higher than the TI spec, and it also is being produced in the area of that Artesia gathering system through which we feel like we have a competitive advantage around procuring, transporting and running those barrels unaltered. So, I'm not avoiding your question, but what I'm suggesting is that I think within reason we're able to buy that WTS barrel and have it to be economically advantaged against what we might otherwise buy as a generic TI Midland.

Paul Cheng
Analyst, Barclays Capital, Inc.
Q

Okay. The last one, Doug, do you have any rough outlook for 2015 CapEx and turnaround expense?

Douglas S. Aron
Chief Financial Officer & Executive Vice President, HollyFrontier Corp.
A

Yes, Paul, I think as we'll complete the Woods Cross project next year and clearly haven't talked to the board about any new projects, but right now, my view going forward would be similarly in that low 400s, $400 million to $420 million probably of CapEx next year with turnarounds being in the $75 million to $100 million range.

Paul Cheng
Analyst, Barclays Capital, Inc.
Q

Thank you.

Operator: There are no further questions on the phone lines at this time. I would turn the call back over to Ms. Julia Heidenreich.

Julia Heidenreich
Vice President-Investor Relations, HollyFrontier Corp.

Thank you all for joining us this morning. If you have any follow-up questions, you can reach Investor Relations for the rest of the day. And otherwise we look forward to sharing our second quarter results in early August. Have a great day.

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