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HFC - Q1 2016 HollyFrontier Corp Earnings Call

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OVERVIEW:

HFC reported 1Q16 net income attributable to HFC shareholders of $21m or $0.12 per diluted share.

CORPORATE PARTICIPANTS

Julia Heidenreich *HollyFrontier Corporation - VP of IR*

George Damiris *HollyFrontier Corporation - President & CEO*

Douglas Aron *HollyFrontier Corporation - EVP & CFO*

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Brad Heffern *RBC Capital Markets - Analyst*

Paul Sankey *Wolfe Research - Analyst*

Doug Leggate *BofA Merrill Lynch - Analyst*

Chi Chow *Tudor, Pickering, Holt & Co. Securities - Analyst*

Roger Read *Wells Fargo Securities, LLC - Analyst*

Phil Gresh *JPMorgan - Analyst*

Jeff Dietert *Simmons & Company International - Analyst*

Evan Calio *Morgan Stanley - Analyst*

Paul Shane *Barclays Capital - Analyst*

Ed Westlake *Credit Suisse - Analyst*

Faisel Khan *Citigroup - Analyst*

Neil Mather *Goldman Sachs - Analyst*

PRESENTATION

Operator

Welcome to HollyFrontier Corporation's first-quarter 2016 conference call and webcast. Hosting the call today from HollyFrontier is George Damiris, President and Chief Executive Officer. He is joined by Douglas Aron, Executive Vice President and Chief Financial Officer.

(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 - *HollyFrontier Corporation - VP of IR*

Good morning everyone, welcome to HollyFrontier Corporation's first-quarter 2016 earnings call. I am Julia Heidenreich, Vice President of Investor Relations.

This morning we issued a press release announcing results for the quarter ending March 31, 2016. If you'd like a copy of today's release you may find one on our website www.HollyFrontier.com.

Before George 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 outcome. Also today's call may also include some discussion of non-GAAP measures. Please see the press release for reconciliations to GAAP.

Lastly, please note that information presented on today's call speaks only as of today, May 4, 2016. Any time sensitive information provided may no longer be accurate at the time of any webcast replay or rereading of the transcript.

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

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks Julia. Good morning, thank you for joining us on HollyFrontier's first-quarter earnings call.

Today we reported a first-quarter net income attributable to HFC shareholders of $21 million, or $0.12 per diluted share. Excluding the $56 million non-cash pretax inventory valuation adjustment, net loss attributable to HFC shareholders was $16 million, or $0.09 per diluted share.

First-quarter EBITDA, excluding the inventory evaluation charge, was $96 million, 78% below the comparable quarter last year. This percentage decrease was due primarily to lower refining margins, and the costs associated with blending ethanol and purchasing RINs to comply with the RFS mandate.

First-quarter crude throughput was 391,000 barrels per day, slightly above our guidance of 380,000 to 390,000 barrels per day. We completed a 50-day FCC LP turnaround in modernization project in Tulsa during the quarter, impacting [crude rate].

We ran 27% sour, and 19% WTS and black wax crude. Our average laid in crude cost under WTI was $1.54 in the mid-con, $4.16 in the Rockies, and $1.43 in the Southwest. For the second quarter of 2016 we expect to run 420,000 to 430,000 barrels per day of crude. We currently have 50 day FCC LP turnaround and modernization project underway in Cheyenne, resulting in reduced rates. In the fourth quarter we have a planned FCC LP turnaround at Woods Cross.

First-quarter consolidated refinery gross margin was $7.59 per produced barrel, less than half of the $16.69 recorded in the first quarter 2015. Margins were impacted by seasonally weak gasoline cracks and continued weakness in diesel cracks.

During the quarter, costs associated with blending ethanol and purchasing RINs to comply with the RFS mandate, had a significant impact as a proportion of earnings. Ethanol, which priced at more than $0.30 per gallon premium, to mid-Con gasoline benchmark in the quarter, resulted in a $36 million negative impact. Ethanol blending economics are improving with the recovery in crude price and improved gasoline margins.

We continue to see strong gasoline demand, encouraged by lower prices at the pump. Consumers are responding by buying bigger cars and driving more. SUV and light truck sales continued to account for nearly 60% of auto sales through the first quarter.

February vehicle miles travel data showed more than a 5.5% increase year on year. As result, 2016 US gasoline consumption could meet or perhaps even exceed record 2017 consumption levels of 9.3 million barrels per day. April gasoline cracks in our regions have increased by 40% to 70% for first quarter levels. I expect cracks to continue to strengthen into the summer driving season.

As important as crack spreads, blending margins, and RINs are, they are largely outside our control. Our focus remains firmly on the things we can control: safe, reliable, cost-effective, well optimized refinery and commercial operations.

In 2016 we are continuing to make progress, executing our business improvement plan. We are targeting $700 million of incremental annual EBITDA by 2018. We are on pace to achieve an incremental $20 million in EBITDA this year, driven primarily by the completion of our large capital investment program and progress an our opportunity capital program.

The Woods Cross expansion project is mechanically complete and scheduled for start up later this month. The crude and poly units have been commissioned and the FCC unit is in the final stages of commissioning. We have also finished work on the crude flexibility component of the project, which improves new piping, necessary for the delivery of a wider variety of crudes, and crude tower modifications to allow for more naptha and distillate production.

We also continue to secure additional crude sources and expect expansion to hit full rates in the third quarter. During the first quarter, significant progress was also made on our opportunity capital program. Our operations and engineering teams successfully addressed constraints at El Dorado, resulting in a new record crude rate of 144,000 barrels per day in March. A 6,000 barrel per day increase from historical levels, achieved at a nominal cost. We expect this expansion to generate $20 million in annual EBITDA.

The recently completed Tulsa FCC modernization project will improve liquid yields and increase capacity, with an expected annual EBITDA improvement of $20 million. The unit is operating well, surpassing our expectations on liquid yields improvement, and running at 25,000 barrels per day, a 2,000 barrel per day increase, which translates to approximately 6,000 barrels per day of extra crude charge capability in Tulsa.

The El Dorado at the bottleneck and increased [cost] of gasoline production should help us further benefit from the strong gasoline margin environment expected this summer. Lastly, we are optimizing our balance sheet and working together with Holly energy partners to increase the value of our MLP, which Doug will discuss in more detail. Overall, HFC continues to build on our competitive advantages within the refining landscape as we progress on the execution of our business improvement plan.

With that, let me turn it over to Doug Aron, our Chief Financial Officer.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Thank you, George.

For the first quarter of 2016, cash flow provided by operations totaled $6.6 million. Turnaround spending in the first quarter total $37 million and first quarter of HollyFrontier's standalone capital expenditures was $132 million.

In 2016 we continue to expect to spend approximately $600 million in standalone CapEx and turnaround spending. As of March 31, 2016, our total cash and marketable securities balance stood at $111 million, a $100 million reduction from year end levels. Cash flow -- cash outflows in the quarter included $192 million in dividends and share repurchases, and again $132 million in capital expenditures.

During the first quarter we repurchased 3.7 million shares at an average price of $34.86. We have $179 million remaining under our existing share repurchase authorization. It remains our expectation that we will continue to return excess cash flow to shareholders, with the pace and volume dependent on free cash flow generation, and the timing and ability to drop down assets to HEP for cash.

Two key components of our business improvement plan, as George previously mentioned, were balance sheet optimization and MLP value growth. During the first quarter, we opportunistically issued $250 million of 5 7/8% senior notes that mature in April 2026. And last week we closed on a three-year unsecured term loan in the amount of $350 million, where we were able to secure a more attractive rate of 200 basis points over LIBOR. We intend to use the net proceeds from the debt offering and term loan for general corporate purposes, including capital expenditures.

HEP is gaining momentum and achieving their 8% distribution growth target. In the first quarter, HEP and HFC completed a non-cash transaction for an interest in the Osage pipeline, and HEP completed the purchase of the Tulsa tankage, which resulted in an $8.7 million charge and the early extinguishment of debt associated with our financing obligation. HEP units have performed strongly, up 6% year to date versus the AMZ, which is down around 1%.

As reminder, HollyFrontier owns 39% of Holly Energy Partners, which is 22.4 million common units, plus the 2% general partner interest. The current market value of our LPs units is approximately $740 million as of last night's closing price, and our first quarter general partner incentive distributions were $12.4 million, a 22% increase over the same quarter last year.

Lastly I will remind you that you can find our monthly WTI-based 321 indicators for our Mid-Con, Rockies and Southwest regions posted on the HollyFrontier investor page. These indicators do not reflect actual sales data and are meant to show monthly trends, realize gross margin per barrel may differ from the indicators for a variety of reasons, and you can find this data at our investor page at www.HollyFrontier.com.

And now, Jennifer, I think we're ready to open the floor to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question is coming from Brad Heffern with RBC.

Brad Heffern - *RBC Capital Markets - Analyst*

Doug, on the debt deal and the term loan, I was wondering if you could talk about what the thinking was behind doing the term loan and how you are thinking about the repurchase program at this point, versus how it was laid out in the analyst day guidance?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Sure, Brad. We had targeted all along to try and raise about $500 million in debt in 2016. The public markets at the time when we came, crude was weakening again and we thought we had seen a window after there were some other issuers earlier that week and it turned out for a variety of reasons that, that market was maybe a little softer than one we anticipated, and we were only able to get half of that $500 million target done. So when we compared that with what the banks believe they could get done for us while we waited for a recovery in that investment grade market, we saw the blend of some floating-rate debt as well as some fixed rate debt as the best option available for our shareholders. That is what we executed on.

At some point that term loan we will expect to take out over the next 18 to 24 months, despite it being a three-year term loan. And now we have a benchmark piece of paper out there that the public markets can point to and say it is out there, it's trading well, those bonds are not trading over par. So that was the rationale on that. And as to analyst day share buyback laid out versus where we are today, obviously we are a little behind the pace, maybe even a lot behind the pace, but I think the margin environment is also very different than what we had anticipated when we sat with you guys last September.

That said, again, we still feel pretty confidently that Woods Cross drop-down is something that will happen in 2016 to HEP. It will happen for cash, we've seen a significant improvement in the MLP market and the ability to get units out the door, which would allow a cash transaction there. Assuming that happens, I think between that and debt raises, there is a possibility of us ramping that buyback program back to the pace that you were expecting.

I don't remember exactly -- I think we had maybe up to $1 billion this year which feels like certainly a stretch goal at this point, just given cash flow generation in the first quarter being well behind what we would've anticipated there. But at the end of the day the message is, we are committed to returning capital to shareholders and that is obviously dependent on availability of that capital, but our commitment has not changed.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, that's great color, thanks for that. And maybe for George, I was wondering if you could delve into the performance of the Rockies during the first quarter, versus the index was the lowest it's been for a couple of years. It didn't seem like your late in crude cost changed real substantially quarter over quarter. Was it local market pricing related or was it again ethanol and RINs, any color would be helpful?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I think the RINs and ethanol as we discuss in general, also apply especially the Rockies, I think that is the biggest explanation for it Brad.

George Damiris - *HollyFrontier Corporation - President & CEO*

The crude price was also a factor. We had WCS advantage there, but I think we had been running closer to $8 to $10 discounts in the Rockies that now are starting to look more like $5, Brad. The crude dips weren't as strong in the first quarter as they had been in previous.

Brad Heffern - *RBC Capital Markets - Analyst*

I understood that, I was thinking about versus the fourth quarter I think the discount was pretty similar. I was wondering what the sequential decline was, but it sounds like it's just the ethanol and RINs explain most of it.

George Damiris - *HollyFrontier Corporation - President & CEO*

Ethanol this quarter was a big deal as you can imagine with a lower crude price in the quarter, ethanol obviously was tied to crude costs as gasoline. Ethanol traded a significant premium to gasoline, the negative of blending margin. That was the biggest quarter to quarter sequential difference.

Brad Heffern - *RBC Capital Markets - Analyst*

And just one quick one, if I could verify something. Once Woods Cross, the expansion is online, that IDR you did a couple years ago, the $1.25 million in the quarter, that will come back into the cash flow stream is that right?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

That is correct.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Thanks.

Operator

Your next question comes from Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

A lot of people are worried about RINs being short next year. You -- is that a concern for you guys, and if you were to go back into a more acquisitive mode, would you be looking to add marketing or would it be more in the refining side?

George Damiris - *HollyFrontier Corporation - President & CEO*

The simple answer is yes. RINs are a concern. I think when the latest RVOs were set, they were set a little bit higher than originally anticipated. I think that was by design, the EPA is intending to hit if not exceed the blend wall. But also their desire is to dry up the pool of RINs that are available for refiners to carryover from year to year.

So all of that is intended to drive ethanol use higher than the blend wall. I don't know if that is a realistic expectation from the EPA, I would be the person to say it is not. Also they are trying to motivate the use of other renewables as well. Including biodiesel, which as you probably know, biodiesel RINs can be applied towards your ethanol RIN obligation.

As far as on the acquisition front, Paul, I think we're interested in acquisitions. I am not sure -- it's not a top priority for us versus the business improvement plan. We will continue to stay focused on that. We will be primarily interested in refining assets because refining assets come with some retail or marketing subsidiary or division, we would be interested in that, but again, it would not be our primary requirement.

Paul Sankey - *Wolfe Research - Analyst*

So basically --

George Damiris - *HollyFrontier Corporation - President & CEO*

What I would say is, owning a marketing division or retail doesn't fix the fundamental problem of RINs and ethanol blending here. Ethanol blending isn't economic like it was in the first quarter, whether you own retail or not, it is still garbage. And I'm sorry for this being a soapbox, but it is the most absurd legislation.

It will, as you point out, if we get to a shortage again -- I think as we saw in 2013 or 2014, my memory is a little unclear, Congress if this gets too far out of whack is willing to act. They won't let this get to a point where there is just not enough RINs and you start paying absurd prices. So I think we take a little bit of comfort in knowing that there is some practical limit before it gets to absurdity and we are continuing to work hard in Washington to see what can be done. Our first choice would be a full repeal in the RFS, that's maybe beyond optimistic. But there are other things that we are working on both as a company individually as well as an industry through AFPM, to do something about just this absurd rule-making.

Paul Sankey - *Wolfe Research - Analyst*

For the record we think it is totally stupid as well. I was just trying to gauge the extent to which you felt it was a threat to your business and appreciate your answers. Thank you.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Paul.

Operator

Your next question comes from Doug Leggate, Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Good morning, everybody. George, obviously a lot of moving parts the quarter. You're signaling a fairly nice rebound in utilization, but can you give us some idea of what you think the lost opportunity cost was in the first quarter as a result of construction downtime and the other disruptions you may have had in the quarter?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think our LPO for the quarter was low, Doug. I think our plans went fairly well, with the possible exception of Cheyenne. We had some issues around the cracker just prior to the turnaround, but I would quantify the LPO around $20 million for the quarter.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Did you have any deliberate run cuts besides the planned maintenance, George, as a result economic run cuts if you like?

George Damiris - *HollyFrontier Corporation - President & CEO*

We had some nominal run cuts in the middle of February for about a week or so. Cracks went negative in the Mid-Con, so we cut about 5,000 barrels per day. For about a week.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thank you. My second question if I may is on ethanol RINs. I'm wondering -- we realize obviously it is still going to be a challenge until we figure things out, but what was the trend so far in the second quarter because obviously that was a sizable hit Q1?

George Damiris - *HollyFrontier Corporation - President & CEO*

The trend again, is getting better on the ethanol blending, because crude prices in the quarter were low and ethanol again does not move in-sync totally with crude price. So as crude price is recovering and as gasoline cracks recovers, gasoline price is pushed up by both the crude price and the gas crack, the ethanol blending margin improves. I think it is still slightly negative but not negative to the tune of the $0.30 per gallon that we saw the first quarter.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thank you. A lot of folks may have overlooked that. Thanks a lot, George.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thank you, Doug.

Operator

Next question comes from Chi Chow, Tudor Pickering Holt.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Back on the buybacks real quick, Doug, given your comments to Brad's question earlier, can we expect the buybacks to be more opportunistic in nature rather than ratable?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I wouldn't think about it that way. I think for the most part we are agnostic to price at this point, at least within reason. It's really more about cash flow generation and whether that cash flow comes from operations or from dropdowns to HEP, I wouldn't think about them being opportunistic versus ratable. This quarter we generated $6 million or effectively nothing in cash from operations. Depending on what you see for second quarter, third quarter and then beyond, presumably it will be higher than that, we hope substantially higher than that.

If it is not, then the pace will be much slower than we hope or expect and if we start to see that ramp up significantly, then again I think buybacks will follow suit. Similarly timing on dropdown of what could be $200 million-plus dropdown to HEP in terms of the Woods Cross expansion, obviously that would be another area of cash flow that would be available for buybacks.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Do you have a specific timing on the Woods Cross drop?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I would say late third quarter, early fourth. We've got to get that unit started up, running and sort of optimized before I think either party would have it make sense to drop back down.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

I guess that expected $200 million level of drop, what does that imply on the multiple?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

We state in what I'd call a market multiple. What you are seeing now is 7 to 9 times is where most refining MLP dropdown have gone in the last 3 to 6 months. There are some exceptions, one notable is a deal outside that range, but 7 to 9 feels to us like the market today.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

And then one final question on CapEx, Doug, did you say this year is $600 million is that right standalone CapEx?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Inclusive of turnarounds.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Where do you stand on the tier 3 gasoline spending by refinery?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think El Dorado, we are finishing up, that money has pretty much been invested. At Navajo we'd probably be spending money through the next year or so through February 2017 and then at Tulsa we are pretty well set. Maybe another couple quarters of cash to invest in that project. And then at the smaller projects we deferred because they are smaller refineries.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

So thought of another way, Chi, most of that capital is in the 2016 $500 million of CapEx that we referenced already, maybe a little bit of spillover, as George talked about into 2017, with Cheyenne and Woods Cross being in the out years because of their small refinery status.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Great. Appreciate it.

Operator

Your next question comes from Roger Read with Wells Fargo.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

I guess if you could talk about diesel demand that you are seeing within your operating footprint. Obviously the year started off weak, but the numbers look better recently, I was just wondering if you could give us a little granularity on what you are seeing?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think that pretty well summarizes it. It is weaker than it has been in the past in our larger customer segments, trucking and the railroads. I would say probably around 10%-ish decline in those sectors and maybe a little bit more for the railroads.

Obviously we didn't have a very cold winter, not that impacts our dealer demand in the regions we operate in, but it definitely does on the East Coast. That contributed to the overall industry overhang of diesel. We are encouraged by recent increases, especially in the ag sectors, the farmers get out and start planting.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Have you have you done anything yield-wise, any adjustments to go more heavily to gasoline or away from diesel or are reprocessing diesel into gasoline?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think most of that we did last year from a purely operational perspective, Roger. Changing our cut points between distillate streams and gas oil and napfa streams, both in the crude units and other downstream units like the cracker where you can make those cuts.

What we are focused on now is we've talked about in our prepared remarks, is some of our opportunity capital projects are geared towards more gasoline production. The Tulsa FCC modernization we talked about, we just completed a similar project we're doing in Cheyenne to do the same type of yield improvement and incremental capacity creep.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I would add that we are already at the top of the peer group with close to 53% in gasoline, versus I think the average is maybe slightly below 50% or right at 50%. We'd love to squeeze another 10% gasoline into the pool, but we just don't think that is feasible and think we are already at the top of the heap, Roger.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay, and just a last question, with the slow decline underway, some might even say a rapid decline, but definitely decline in US crude production, are you seeing any changes in crude availability at this point across any of your refineries?

George Damiris - *HollyFrontier Corporation - President & CEO*

The short answer to that is no. I think we are most concerned is around the Woods Cross expansion as we've talked about before. The availability of wax crude and other crudes to feed our expansion. But having said all that, we have secured additional sources as we said in our prepared remarks, and are working with other suppliers and transportation pipeline service providers to ensure we have what we need to keep that expansion full.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay. Thank you.

Operator

Your next question from Phil Gresh, JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

First question is on the RINs, sorry to come back to this, but can you give us the 1Q actually RINs cost as well as last year's, and how your full year expectation would line up relative to last year?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think on the RIN cost, it really hasn't changed much over the last few quarters. It runs about mid $40 millions, $40 million a quarter.

Phil Gresh - *JPMorgan - Analyst*

Okay. So you're not expecting a step up year over year?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

So, what I would say is, we have seen it be as high as $54 million in a quarter, at least over the last 1-1/2 years. I think as George said mid $40 millions, Q1 -- you do think there is some averaging that goes on in terms of the RIN cost, where you purchase them, so some carryover that might have been used in previous years. What I would say is that approximates mid-$50 millions RIN price for that $46 million we spent this quarter. Current market is higher than that, in the low to mid $70 millions. As we burn through our lower cost RINs and start getting into the higher price RINs, you'd expect that number to creep up into the next quarters going forward.

Phil Gresh - *JPMorgan - Analyst*

That's helpful. On the OpEx side, costs were very low in the quarter in particular in the Southwest region which is below the run rate of last year, was there anything one time in the quarter on the Southwest OpEx?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

No. Nothing one time would highlight a big portion, about 40% of the decrease of cost was due to natural gas or fuel cost. So that is running about [$2, $1 million] for natural gas

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Phil Gresh - *JPMorgan - Analyst*

Last question is the $200 million incremental EBITDA number that you talked about, it sounds like a lot of that is in process and so I assume not much was achieved in 1Q. But maybe you can clarify that and then is the $200 million more of a run rate that we should be expecting by year end? How should we think about that?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I think that's exactly right. That's a year end run rate. I think, again, the two biggest pieces to that are the Woods Cross expansion that we've highlighted in the past is 480 million to $100 million of that $200 million. And then as far as the rest of it, we tried to give you a feel for that with the Tulsa modernization being $20 million and the El Dorado crude expansion being another $20 million. So those are the largest components of that.

Phil Gresh - *JPMorgan - Analyst*

Thank you.

Operator

Your next question comes from Jeff Dietert with Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

I was hoping you could talk a little bit about asphalt and what kind of prices you are seeing. I guess second and third quarter are the primary quarters, I think sometimes you sell some of this in advance. Could you talk about your pricing and remind us of your volumes, I assume they are going up with the discounts that we are seeing for Canadian heavy?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think our yield of asphalt typically runs about 1% to 2% of our crude rate. I think asphalt demand is looking pretty strong so far this year and we have a low price environment, this fixed state budgets further obviously as a lower cost of asphalt. Asphalt's typically running in about 80% WTI. $130 a ton, so if you want to divide that by 5-1/2 to get it to dollars per barrel. In addition to asphalt, we sell a lot of roofing flux out of Tulsa and that typically commands appreciable premium say, $100 to $150 a ton over asphalt.

Jeff Dietert - *Simmons & Company International - Analyst*

With the recent increase in oil prices, is that squeezing asphalt margins for the second quarter or have you been able to sell forward some volumes and lock in better margins?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Usually with a lot of these asphalt contracts, Jeff, there is an escalator that is associated with the crude price. So it should be agnostic to the margin, should adjust for the increasing crude price.

Operator

Your next question comes from Evan Calio with Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

My first question is on the Woods Cross expansion. All those changes drive the EBITDA in 2Q, or is are some phase in tied with maintenance? And related, I know you have volumes out of [UNEV], what is your assessment of the effect of that ramp up on this local markets, given current conditions?

George Damiris - *HollyFrontier Corporation - President & CEO*

Could you go back to the first part of your question? I'm not sure I followed.

Evan Calio - *Morgan Stanley - Analyst*

Just trying to understand when the incremental EBITDA that you discussed for the full year, are all the units up and running in the second quarter, or are some of those elements in the third quarter, in around fall maintenance?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think if you want to model it in, I would stay on the conservative side and say that the EBITDA starts in the third quarter. So that $80 million to $100 million run rate that we just talked about, I'd model $40 million to $50 million of it in the second half of this year and then $80 million to $100 million starting for full-year 2017. I'm sorry.

And then I think on your UNEV question and the impact on local markets, we would view the majority of our expansion gasoline and diesel production going down UNEV. We might be able to squeeze some more into the Utah and Idaho markets, but those are well served now obviously, so incrementally I think it is safe to assume that the majority of expansion volume is going to go down UNEV.

Evan Calio - *Morgan Stanley - Analyst*

And a follow-up question I had on M&A, would you say that your view on potential M&As is now tempered? That's what it sounded like incrementally from your prior response. I know there has been some private assets on the market and your focus appears your projects and the buyback priority, given the various uncertainties on the macro.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the view on M&A is it is very opportunistic, you never know when an asset is going to become available. I think if and when assets become available that are attractive to us, we are going to look at them. And obviously when we are in a tighter refining margin environment like we are now, it makes you think even harder about it. But again, these properties don't come up available for sale very frequently. So, again if an asset comes up that's appealing to us, we're going to pursue it.

Evan Calio - *Morgan Stanley - Analyst*

If I could squeeze one more in. I know you Doug shared your view on TI brent differentials, but what is your view here for the rest of the year? A little bit wider, I know the industry has recently exited turnarounds in the Mid-Con, Roger had mentioned declines. How do you think about the contribution from a differentials like differential in 2016?

George Damiris - *HollyFrontier Corporation - President & CEO*

As far as the brent WTI spread, I think it being around the $2 level it is now. Same thing for the coastal differentials for WTI, say in Houston and [LLS]. All those should be in that $2 region.

I think fundamental transportation costs would argue for a wider differential for WTI in Houston, but I think there is excess capacity both from pushing in Midland to get WTI barrels from those two locations to Houston. So the differential is trading below full transportation costs. I still think $2 is a good number.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

And I'd echo that and say that obviously we read what you guys write and appreciate that there is a trend towards preference for Gulf Coast refining and siding with the lower US production could lead to tightening of that spread. And we've seen that some already, as George has talked about, we've seen some fluctuation in that spread. And short term you can see anything in our opinion. At the end of the day if you're inland producer, do you really want to put a barrel on a pipe and pay a tariff to move it to the gulf coast and get a lower net back, ultimately when you get there?

We think as we said now even dating back to the time when pipelines are been reversed in 2013 and 2014, that eventually that spread should look like a transportation differential. And so we think our geography suits as well in terms of being close to that crude barrel, depending on which refinery we are talking about. And our guess is probably slightly more educated than most, but that is where we think it is, as George said, maybe $2 this year. And probably growing between flat to $4 long-term, just depending on where the crude is being produced and what different discounts are there.

Evan Calio - *Morgan Stanley - Analyst*

Great. You can put me down in the RFS camp being incredibly flawed as well. (Laughter)

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

We will send you a petition.

Operator

Your next question comes from Paul Shane with Barclays.

Paul Shane - *Barclays Capital - Analyst*

I have a couple questions, hopefully it will be quick. The first one, when looking at (inaudible) number basis you have a tax expense, even though your pretax income would be a loss if we are excluding the minority interest from the tax income, is that is some kind of tax adjustment that negatively impacting you?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Paul, we saw your note this morning and as we work through the math think maybe somebody had the signs reversed. We calculated our effective tax rate being about 34% for the quarter, and that is slightly below what you would have expected to see as a 38% or so tax rate. Because HEP, which we get favorable tax treatment on, was a larger percentage of our earnings this quarter.

So we would be happy to work through that with you, but the HEP earnings being a larger percentage we also had a small number in terms of manufacturing tax deductions that slightly lower the rate. But we show it at 34% and Julia would be happy to walk through that with anyone.

Paul Shane - *Barclays Capital - Analyst*

I would take it off, one of my associates will call Julia on that. The second one, just want to make sure that George when you're talking about $36 million that really is just on the blending economic loss?

George Damiris - *HollyFrontier Corporation - President & CEO*

That is correct.

Paul Shane - *Barclays Capital - Analyst*

That's not including the additional RIN cost that you pay, right?

George Damiris - *HollyFrontier Corporation - President & CEO*

That is correct.

Paul Shane - *Barclays Capital - Analyst*

And I don't know because it seems like I have not heard other people that in this quarter (inaudible) is a major issue, because based on the number that it seems like your margin realization loss by about $1 per barrel. We haven't heard other people citing in that magnitude or at least. Just curious is it the way of how you guys sell your product to your customer is different than some of your peers or is it really uniquely in your market that is causing you to have a much higher blending losses than other people?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

No, we don't think so. We are buying ethanol at market and we're selling our products at market. It is the same market that everybody else is buying and selling into. Again, it's a big proportional impact on us because, again margins are small, so you're dividing a relatively fixed number in the RIN charge anyway, by a smaller gross margin number. The percentage looks exaggerated because, again you are dividing by a small gross margin number if you will.

Paul Shane - *Barclays Capital - Analyst*

Let me ask you another way what is the percent of you gasoline sales is mixed gasoline, and how much is that including ethanol when you sell?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

We've said the past that we blend about half and sell about half, both as clear barrels.

Paul Shane - *Barclays Capital - Analyst*

Some of your peer actually when they sell that they really invoice separate out what is the [mixed] gasoline price and what is the ethanol price, I assume you guys don't do that. That's why you couldn't (inaudible) fully. And why the industry is not moving in that direction? If everyone that basically -- when you sell the finished gasoline, why not just break it out between what you pay for the mixed gasoline and what is the ethanol and just become a [pass-through]?

George Damiris - *HollyFrontier Corporation - President & CEO*

Remember, again, Paul, this is the first quarter in a longtime that ethanol margins have been negative. Again, it was driven primarily by the low crude price dragging down the gasoline price with it. So, the other relevant point here to remember is even if peers that have retail associated with them, they are buying ethanol and blending it as well, and again, we are not overpaying for ethanol and not under --

Paul Shane - *Barclays Capital - Analyst*

No, no George, I think I understand what you just say. I am just saying that for the industry it seems that you are trying to make money by the mixed gasoline by your manufacturing, not by taking the (inaudible) on ethanol. Why not the industry moving to the system so that when you send an invoice to your customer you charge them what is the mixed gasoline and then that the ethanol becomes a pass-through add-on, sort of like the fuel surcharge by the transportation company. By doing it this way you eliminate that fluctuation. Yes, when oil price is high you may give up some branding economic but when oil price is low, you don't have (inaudible) loss. That may be just a stupid idea from me, but anyway. Thank you for your time.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thank you, Paul for your thoughts.

Operator

Next question comes from Ed Westlake from Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Good morning, some of the other folks in the industry have been flagging ethanol. It is out there. I just had a quick small question on it though.

Where in your accounts are you putting it, is in refining operating expenses or somewhere else?

George Damiris - *HollyFrontier Corporation - President & CEO*

It's in cost of goods sold.

Ed Westlake - *Credit Suisse - Analyst*

Okay, so then on your refining operating expenses, they went from $236 million to $228 million. Obviously natural gas came down a lot. You're targeting a reliability and cost improvements of around $195 million from the Analyst Day. Maybe just walk us through your delivery milestones in terms of some of the refining operation improvements, because that's a big chunk of the $700 million.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think round numbers OpEx reduction target was right around $100 million. And I think what we've explained in the past is that we achieved about $30 million of it last year. I think we're seeing some of that come through in the first quarter here. One of the reductions we had in operating cost was about the same magnitude as natural gas, was lower maintenance related, what we call XO or extraordinary projects, so that been the savings was about the order magnitude of lower fuel costs this quarter. About $10 million for the quarter.

Ed Westlake - *Credit Suisse - Analyst*

I'm not seeing in the headline numbers. I appreciate there's lots of other moving parts.

George Damiris - *HollyFrontier Corporation - President & CEO*

Julia has a breakdown that she can provide, but again, overall we are doing well and the OpEx portion of our business improvement plan. And a lot of that as you noted is reliability related, when you run your plants reliably you need less maintenance cost and that's less of this XO project category that we just finished talking about.

Ed Westlake - *Credit Suisse - Analyst*

And then on the opportunity investments, obviously you've talked to some of bigger larger capital projects and obviously having a good year this year in terms of bringing some of those on. As you think about that's other bucket which was much smaller, any updated cadence in terms of when you would expect them to hit between now and the longer term?

George Damiris - *HollyFrontier Corporation - President & CEO*

As far as opportunity cost that, I think the best way to think about that --

Ed Westlake - *Credit Suisse - Analyst*

Opportunity investment, sorry.

George Damiris - *HollyFrontier Corporation - President & CEO*

Opportunity capital. I think, thinking about that as being $50 million of EBITDA each year from last year through 2018. So we're going get $200 million in that bucket in $450 million annual additions.

Ed Westlake - *Credit Suisse - Analyst*

And in terms of the -- those are more difficult to see in terms of your confidence, has it changed or since the Analyst Day?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think if anything I am more optimistic in what we are seeing because of projects like the El Dorado crude expansion that we just highlighted in our prepared remarks. That one was a phenomenal effort by operation and engineering teams again to get 6000 barrels per day of additional crude rate out of the units that we've run historically at 138. With nominal, less than $1 million of capital. That is really an outstanding application of intellectual capital to replace capital investment.

Ed Westlake - *Credit Suisse - Analyst*

And final one for me. [Loops], just any color on how margins were in Q1 and Q2?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think Q1 the margins were a little bit better because crude prices lower, and whenever there is a crude movement those prices are stickier than the crude price.

Ed Westlake - *Credit Suisse - Analyst*

Okay so somewhat of a benefit in a quarter versus the normal run rate.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the crack very good, the crack was down, flat to down slightly, with fourth quarter was actually pretty good too.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

We actually made basically 1 percentage point more, the cracks were marginally down. So net-net it was a wash basically versus the previous quarter.

Ed Westlake - *Credit Suisse - Analyst*

Okay. Thanks very much.

Operator

Your final question comes from Faisel Khan, Citigroup.

Faisel Khan - *Citigroup - Analyst*

Good morning. Just want to understand on the ethanol and RIN questions that have been asked ad nauseam, there was nothing out of the ordinary out of the industry norm that took place with you guys this quarter versus other companies that are reporting this quarter? Just want to make sure I got that right.

George Damiris - *HollyFrontier Corporation - President & CEO*

That would be our expectation.

Faisel Khan - *Citigroup - Analyst*

Okay. Got you, good. And then going back to the RIN price and how you expect to have a bigger impact, you expect the cost to be higher as we go through the year. I would've thought that with gasoline demand getting higher this year or last year there would be more opportunity to generate wins in the market because of discretionary blending. I'm trying to understand is that opportunity not there or is gasoline demand growing year over year? Or is there something else?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the biggest difference is RBO, that was published in November was higher than anticipated, so that drove the RIN price from roughly $0.50 per RIN at that time to the $0.70 level that it is now.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

The other point is, when you look at first quarter, ethanol margins were negative so you compare the two, you compare the cost of the RIN versus blending and that's the other component.

Faisel Khan - *Citigroup - Analyst*

Okay, understood. And then on the Navajo refinery, it ran very well in the quarter especially versus last year. I'm just trying to understand the product mix a little bit. Looks like you produced on a percentage basis more distillate in this quarter versus last quarter, and gasoline was down a little bit too, I'm just trying to understand what is taking place there.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

That's quarter on quarter?

Faisel Khan - *Citigroup - Analyst*

Year on year.

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

I think one of the things you are seeing there is we implemented a project last year that allowed us to draw more diesel off of the crude pillar. That diesel draw allowed us to increase our crude rate. Maybe on a percentage basis the distillate yield went up, but on absolute volume basis that allowed us to run more crude at the refinery.

Faisel Khan - *Citigroup - Analyst*

Okay, got it. Thanks for the time.

Operator

We do have a follow-up question from Neil Mather with Goldman Sachs.

Neil Mather - *Goldman Sachs - Analyst*

Want to take off with you on just leverage levels. And I think in the past you talked about net debt to EBITDA being one turn being the target level. Is that the still the right level for you guys, one times X HEP?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Yes, I'd say as a blanket statement that is true. In an acquisition for a period of time would you go higher than that if there was reason to do so? I think potentially, but probably not more than 1-1/2 times for that instance and then obviously the big question is what is EBITDA? But what we laid out at Analyst Day, I think was generally $1 billion of debt sort of in the outlook time we were looking at, which was from now until 2018. And I think we still feel like that is the appropriate amount of leverage.

Neil Mather - *Goldman Sachs - Analyst*

That's great. My last question is operational performance thus far in the second quarter, I know it's early, but on a turnaround adjusted utilization rate is everything tracking towards the plan?

Douglas Aron - *HollyFrontier Corporation - EVP & CFO*

Yes. Everything is going well.

Operator

We have no further questions in queue to at this time and I would like to turn the floor back over to Julia for any closing remarks.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Thank you everyone for joining us today. As always if you have any follow-up questions or would like to discuss any of these other items in the Q&A in detail I will be around all day, just reach out. And with that I will look forward to sharing our next quarter results with you in August. Have a good day.

Operator

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