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HFC - Q3 2016 HollyFrontier Corp Earnings Call

EVENT DATE/TIME: NOVEMBER 03, 2016 / 12:30PM GMT

OVERVIEW:

Co. reported 3Q16 net income attributable to HFC shareholders of $74m or $0.42 per diluted share.

CORPORATE PARTICIPANTS

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George Damiris *HollyFrontier Corporation - President & CEO*

Doug Aron *HollyFrontier Corporation - EVP & CFO*

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Roger Read *Wells Fargo Securities, LLC - Analyst*

Phil Gresh *JPMorgan - Analyst*

Ed Westlake *Credit Suisse - Analyst*

Paul Cheng *Barclays Capital - Analyst*

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Neil Mehta *Goldman Sachs - Analyst*

Paul Sankey *Wolfe Research - Analyst*

PRESENTATION

Operator

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

(Operator Instructions)

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, and welcome to our third-quarter conference call. This morning we issued a press release announcing results for the quarter ending September 30, 2016. If you would like a copy of the release, you may find it on our website, 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, adjustments, 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, the call may include discussion of non-GAAP measures. Please see the press release for reconciliation to GAAP financials. Lastly, please note that the information presented on today's call speaks only as of today, November 3, 2016. Any time sensitive information provided may no longer be accurate at the time of any replay of the webcast or rereading of the transcript. And with that, let me turn the call over to George Damiris.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Julia. Good morning, everyone. Thank you for joining us on HollyFrontier's third-quarter earnings call. Today, we reported third-quarter net income attributable to HFC shareholders of $74 million or $0.42 per diluted share. Third-quarter EBITDA was $207 million, 49% below the comparable quarter last year primarily due to the combination of weaker benchmark margins, an increase in compliance costs associated with the RFS mandate. Crude throughput was 444,000 barrels per day, within our 440,000 to 450,000 barrel per day guidance range. We ran 25% sour and 20% WCS in black wax crude. Our average laid-in crude cost under WTI was $0.69 in the Mid-Con, $4 in the Rockies, and $1.27 in the Southwest.

Our plants ran faithfully and reliably during the quarter with El Dorado and Tulsa each setting new processing and production records. Out of our Tulsa facility, we sold 12,400 barrels per day of lubricants at an average crack of $62. Unfortunately, excellent operational reliability was overshadowed by weak industry margins and escalating RFS compliance costs. Consolidated refinery gross margin was $9.83 per barrel, 60% below the $19.85 recorded in Q3 of last year. We spent $63 million purchasing RINs in the third quarter, which in the low margin environment, has a significant impact as a proportion of earnings. For the fourth quarter, we expect to run between 440,000 and 450,000 barrels per day of crude. We have a turnaround underway on our Woods Cross FCC, which will impact crude rate in the Rockies in the quarter.

I'd like to now take a moment to provide additional detail about our growth aspirations. Earlier this year, we developed our vision with the objective to double the size of each of our businesses, refining midstream and lubricants by 2020. We wanted a vision that was not only inspirational to help create the proper frame of mind for developing the strategies and culture needed to achieve our mission but also a vision that was well-grounded in facts and reality. The analysis of our markets indicates the doubling of size of our existing refining business was becoming industry standard. For example, the average capacity of independent refiners has grown to 1 million barrels per day versus the 500,000 barrels per day at the time that Holly and Frontier merged.

Across our three business areas, refining, midstream, and lubricants, the benefits of scale provide important competitive advantages. Importantly, we see value in scale not just in terms of system integration, crude or feedstock supply, and product [monitor] synergies, but also in terms of talent acquisition. We believe that there are opportunities out there for us to capitalize on our strong financial position and cash generating capabilities to profitably grow HollyFrontier. Looking ahead, we will continue to work towards growing both our refining and midstream businesses. At this point in the cycle, we see opportunity to grow HEP.

Given the quality of our midstream assets and strong parental support, we feel we have a great base from which to grow and participate in midstream consolidation with primary focus in our existing geography. As we discussed earlier this week, Petro-Canada Lubricants represents the type of opportunity we are looking for. We will continue to operate in a challenging refining environment and see the value of diversifying our income stream. Our acquisition of PCLI will do just that, add diversity and scale to HollyFrontier. With this acquisition, HollyFrontier will become the fourth-largest lubricant producer in North America.

Importantly, Petro-Canada Lubricants has integrated across the value chain from base oils to finished products with a global recognize brand and distribution platform delivering 12,000 high-margin products to end customers worldwide. This is a transformative acquisition for HollyFrontier. We anticipate lubricants will account for over 20% of refining earnings in a normalized environment and well above that level in a low fuels margin year like this year. The addition of Petro-Canada Lubricants to our existing Tulsa lubes production accentuates an underappreciated part of our business. Going forward, lubricants will be a key component alongside our high-quality refining and midstream businesses. Ultimately, we expect our increased scale in lubricants and the more stable cash flows and higher margins that business will generate to be reflected in our Company's valuation.

Let me be clear, this does not mean we will overpay for assets just to meet the goal of doubling our refining, lubricants, and midstream businesses. We will continue to be disciplined with our capital allocation, and we'll only pursue prudent acquisition opportunities. That means we will actively look to take advantage of the right opportunities at the right price that might become available in our markets of interest, similar to Petro-Canada Lubricants. We will remain opportunistic in our pursuit of value-enhancing high-return acquisitions. It is also important to note that although we intend to deploy capital to fund external growth opportunities over the next few years, returning capital to shareholders has long been a priority at HollyFrontier. That will not change.

Since our merger in 2011, we have returned more than $4 billion through special and regular dividends and share repurchases to our shareholders. We remain committed to maintaining a competitive dividend yield relative to our peer group, and we'll continue to drive shareholder value creation by returning capital going forward. Although the current environment for refiners remains challenging, HollyFrontier will be even better positioned given our strong balance sheet, excellent liquidity position, and the more stable cash flow from our lubricants business. With that, let me turn it over to Doug Aron, our Chief Financial Officer.

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Thank you, George. Good morning, everyone. We appreciate you joining us this morning. For the third quarter of 2016, cash flow provided by operations totaled $128 million. Turnaround spending in the second quarter totaled $32 million, and HollyFrontier's standalone CapEx totaled $79 million. As a reminder, we plan to defer about $40 million in capital spending this year, which will take our 2016 capital and turnaround spend to a total of approximately $560 million for this year. We expect 2017 capital and turnaround spending to be between $400 million and $450 million depending on the 2017 margin environment.

As of September 30, 2016, our total cash and marketable securities balance stood at $478 million. The Woods Cross expansion asset dropdown was completed on October 3 for total cash consideration of $278 million, which took our cash position to $756 million. We have $600 million of standalone debt and no drawings under our $1 billion revolving credit facility. This puts our current liquidity, including dropdown proceeds, at $1.75 billion, and debt to cap, excluding Holly Energy Partners, at 11.4%. HEP units continues to perform strongly. HollyFrontier owns 35% of HEP, that's is 22.4 million comp units plus the 2% general partner interest. The current market value of our LP units is approximately $675 million as of last night's closing price.

As a reminder, HEP recently announced its 48th consecutive quarterly distribution increase and is gaining momentum in achieving their stated 8% distribution growth target. Second-quarter GP incentive distributions were $15.2 million or a 41% increase over the same quarter last year. As George already mentioned, earlier this week, we announced the acquisition of PCLI's business for approximately $845 million. We expect to fund the purchase price with a combination of cash on hand as well as a potential new senior note issuance. To illustrate our balance sheet capacity, the addition of $500 million of debt would modestly increase our standalone debt to cap from 11% to 19%. We are confident we will maintain our investment-grade rating with this acquisition and the anticipated financing scenario.

The Petro-Canada acquisition will transform HFC from a pure play merchant refiner to a more diversified Company with scale in a high-margin fully integrated lubricants business. Given the premium margins and lower volatility of the lubricants business, we expect higher lubricants valuation to increase the multiple for our consolidated Company. Day to day, we remain focused on our internal initiatives, however the refining environment has changed considerably since we last laid out our initial business improvement targets. The challenging refining environment and escalating burden associated with the RFS mandate highlights the value of diversification achieved through the Petro-Canada acquisition. HFC has a long history of acquiring assets at times like this. We expect 2017 to bring further possible external opportunities in both refining and midstream.

As George mentioned, we will remain disciplined in our approach to achieving our vision and will continue to be disciplined with our capital allocation and evaluating external opportunities. Lastly, a reminder that you can find monthly WTI-based 321 indicators for our Mid-Con, Rockies, and Southwest regions posted on the HollyFrontier investor 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 the indicators for a variety of reasons. You can find the data at our webpage at HollyFrontier.com. And with that, Angel, I believe we are ready to open the floor for questions.

QUESTIONS AND ANSWERS

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

(Operator Instructions)

Brad Heffern, RBC Capital.

Brad Heffern - *RBC Capital Markets - Analyst*

Good morning, everyone.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning, Brad.

Brad Heffern - *RBC Capital Markets - Analyst*

Hey, George, on your M&A commentary before about the 1 million barrel per day goal, I'm curious you said you'd prefer assets in your existing markets, but at the same time your existing markets tend to have a relatively small refining footprint. The average across your assets is less than 100,000 barrels a day. So would you consider doing a deal outside your existing footprint potentially with a larger asset in order to get you more throughput? And how do you think about the balance between those?

George Damiris - *HollyFrontier Corporation - President & CEO*

Well, first and foremost, like we said, we're going to maintain our focus on value and quality of assets, so our strong preference would be to find high-quality assets within our own geography, even if they don't get us to doubling the capacity of our refineries, Brad. We will only buy a good asset, a good value outside of our existing geography if it is indeed good value. Again, the doubling vision is again, meant to be more inspirational than concrete. We're going to focus on value of the asset we buy, just like the Petro-Canada Lubricants deal, over volume. It would have to be a good deal at a good price.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Understood. And then I wanted to give you the opportunity to talk about RINs a little bit. Can you give your expectations for what's going to happen here at the end of November, and also talk a little bit about the commentary that you're hearing back on changing the point of obligation.

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, I mean, Brad, the truthful answer to that is who really knows at the end of the day. We have our government affairs people all over this. I've been spending a lot of time in Washington myself. Doug has as well. As far as what's going to happen in November, we don't expect much to change versus the current expectations that the PA has set for next year's RVO. We would like to think they are going to come off of those RVOs a little bit we would not expect it to be material. So I wouldn't expect much to be revolutionary or evolutionary there on that front.

As far as the point of obligation, I think we're making steady headway and progress there. Having said that, we still have a long way to go. Everybody we speak to understands the issue, agrees with us that it's unfair on independent refiners to have obligation be solely on us when others are reaping windfall profits on it. But it's going to take some time to work through the process in Washington, but we're optimistic because of the progress that we're seeing and the feedback we are getting from the people we are talking to.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Thanks, George.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Brad.

Operator

Roger Read, Wells Fargo.

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

Yes. Thank you. Good morning.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning, Roger.

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

George, I guess we could talk a little bit about sort of the inventory situation in Pad 2. Diesel has been kind of stubbornly high versus normal, gasoline not so bad. I'm just wondering how you look at that market cleaning itself up here as we go through the wintertime, what we should be watching for.

George Damiris - *HollyFrontier Corporation - President & CEO*

Well, I think the number one thing that would help us honestly is a cold winter. I think what triggered a lot of the inventory built in diesel across the board was the very warm winter we had last year. Having said that, we all hate to bet on weather conditions to bail us out of an inventory position but the other thing contributing to inventory builds was demand has been pretty weak outside of the heating sector [year to year].

The railroad activity is off, trucking volumes are off, and I think you saw refiners adjusting accordingly by shifting gasoline production or diesel production to gasoline earlier this year. I think there might be a little bit more of that left to come but I don't think there's much left there. We just have to see an increase in industrial activity in the US that drives again trucking and the railroad sectors, and hopefully a colder winter, at least a normal winter relative to the warm winter we had last year.

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

Okay, great. Thanks. And then, Doug, this is probably a little more for you. Obviously, the lubes acquisition is going to affect the balance sheet in terms of at least a net debt increase depending on exactly how it all gets financed. Cash flow this quarter, pretty close to covering all the obligations, but I'm wondering as you look to next year you think about these acquisitions you'd like to -- I say next year, next couple years the doubling of the size of the business, how should we think about a reasonable financing option from HollyFrontier for expansions either in logistics or refining going forward?

George Damiris - *HollyFrontier Corporation - President & CEO*

Fair question, Brad. I'm sorry, Roger.

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

Roger, Brad, whatever.

George Damiris - *HollyFrontier Corporation - President & CEO*

No, no, sorry. I was still thinking to the previous question. Apology for that, Roger. But on financing, what we've said is that maintaining investment-grade rating is important to us and we believe gives us a competitive advantage such that capital markets are available to you and sort of in any market, and that wasn't always true. When you get into tougher financing markets, it's certainly preferable to be investment grade.

So in order for us to do that, guidelines we've seen from the rating agencies have indicated keeping your debt to cap, or debt to EBITDA anyway, at sort of less than 2 times given our size and scale. But they've also told us that as you add size and scale, you get more benefit on that metric. So what I would tell you is, we've historically been a very conservative sort of targeted debt to EBITDA of 1 times. I would say probably looking forward 1.5 might be where we get, maybe pushing towards 2 times at an actual acquisition time with an expectation of quickly paying that back down more than comfortable 1 to 1.5 times range.

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

Okay. Thank you.

Operator

Phil Gresh, JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

Hello. Good morning.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning, Phil.

Phil Gresh - *JPMorgan - Analyst*

First question will just kind of be a follow-up to the balance sheet target. So it sounds like you have some pretty aggressive goals out there longer term. If my math is right after the lubes deal, you would be on a net debt to EBITDA basis kind of approaching 1 but probably still below 1 times with kind of the target of 1.5 to 2. So as you pursue opportunities, would you be willing to issue equity for a deal if a larger deal came along that fit your parameters?

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Yes. I mean look, I think the answer is everything is going to be case-by-case dependent. If there's accretion in transactions and we can maintain the appropriate leverage targets, maintain our investment-grade rating, then we'll consider all different forms and opportunities. I guess I would reiterate sort of the way George concluded his prepared remarks, Phil, with to your comment of our aggressive or aspirational targets. I think it's exactly that, and I know this feels like a bit of a different tone from us, but what George is suggesting is we think we have a platform and a balance sheet for growth.

We think certainly the Petro-Canada acquisition shows you the type of growth we are interested in, which is immediately accretive, not what I think anybody would think of as a very high-risk transaction. So those are the kinds of things we will continue to look for as time marches on, and very much the same pattern you've seen from us in terms of deals and the way we finance them and the kind of deals we buy is what we will be looking for but with more of a focus on that from management on a day-to-day basis. George, is that the way you'd sort of reiterate it?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, yes, and trying, maybe trying to boil it down to what was the line of thinking Phil had. I think you thought of 1 time EBITDA as a debt target for us is a good thought, Phil, but for the right deal. Again, if it fits us well and that we think has value, we would be one to go above the 1 time EBITDA with the expectation that after that deal is done, that we would work real hard to get back to that 1 times target.

Phil Gresh - *JPMorgan - Analyst*

Okay. Thanks. Second question is, in terms of the change in tone that you mentioned, Doug, the buybacks last year were over $700 million, obviously at a higher price for the stock, and now it seems like that there's much more of a focus on acquiring for growth. Should we interpret that the buyback just doesn't compete as much as the use of capital? And how do you think about the IRR of acquisitions versus buying back your own stock if you're in the low 20s?

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Well, I think it's very time-dependent, Phil. When we were buying back stock last year, we really didn't see much in the way of external opportunities out there. Refining margins were substantially higher in 2015. All businesses were doing well and healthy and there really wasn't much on the market, or at least that was interesting to us. And as we looked at our own shares relative to our business improvement plan and where we expected the 2016 margin environment to be, those looked attractive to us.

The 2016 margin environment and RINs environment turned out to be substantially different than what we expected, and we started to see that in January, February timeframe, certainly looking at the forward strip, which is when we really stop buying back shares certainly at the rate that we were. And as said, even though the share price itself looks very attractive, the current business environment is not as attractive, particularly for a company that was planning to spend at the time $600 million on CapEx in the year, and we didn't expect free cash flow generation to cover that.

We continue to pay and will continue to pay a very competitive regular dividend, and so all of those things go into the way we think about capital allocation, and as we look at deals going forward, again, it will be dependent on what does the deal bring us. Not just a financial metric. Yes, we look at IRR in both of them are there diversification benefits that might outweigh a slightly higher IRR on buying back your own stock.

Phil Gresh - *JPMorgan - Analyst*

Okay. And just one clarification, Doug. The CapEx for 2017 of $400 million to $450 million, I think the quarter was $400 million. Is the difference just that you're including lubes in there, or was that a pre-lubes number?

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

That's a pre-lubes number. I'd also tell you I still think $400 million is an achievable target. We're seeing forward margins strip since we last announced on our last quarterly call are up certainly on the diesel side. They are little higher despite the higher inventories. Forward margins look a little better. We do have some opportunity capital that is part of the business improvement plan we announced that we see as very quick hit high return, but we are giving more of a range at this point as we're just not certain whether we want to spend that capital depending on the margin environment.

Phil Gresh - *JPMorgan - Analyst*

Okay. Thank you.

Operator

Ed Westlake, Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Hello, guys. Good morning. Two questions, if I may. The first one is just around Woods Cross and Cheyenne. Obviously there's so a lot of work going on this year at those two refineries -- (inaudible) left alone, maybe give us a roadmap as to how to think about Q4 and Q1.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the first thing to know about Woods Cross, and I think we've said this before, is we still have a lot of gas oil inventory that was built up in anticipation of the startup of the expansion so a lot of that was being run off in the third quarter. And the we have the Woods Cross -- the old FCC, if you will, Woods Cross currently in turnaround and we are appearing for that even in the third quarter. So coming out of the turnaround, we will again have gas oil inventory that was built with that FCC being down. So long-winded way of saying that we don't anticipate much difference in crude rate at Woods Cross in the fourth quarter versus the third quarter because again, we will be running off the inventory of gas oil that's going to be built-up during the FCC turnaround.

The comment applies to both Woods Cross and Cheyenne is -- we're seeing key differentials tightening appreciably in both of those areas as with this low crude price environment. So a lot of the [stock in this] the [you could] we run it at Woods Cross, the black wax crude, those crudes, the supply is not as prevalent as it has been in the past, and that's reflected in the crude differential we see. Our incremental barrel at Woods Cross now comes from Canada. It's a Syncrude or Syncrude comparable in these crude [diffs] tight crude environment. Those incremental barrels are not as economic as the used to be when the price of crude was $100 and supply of those crudes was more prevalent. So again, a long-winded way of saying that I think what you saw here in the third quarter is going to be what you are going to see in the fourth quarter in the first quarter out of our Rockies sector.

Ed Westlake - *Credit Suisse - Analyst*

Okay, thanks. And second question is really another follow-on from the conference call on Monday. Thanks for that on the lubricants. So since then doing some digging finds that companies like Valvoline are saying that there was that big buildup in capacity through to 2014, then all that bullish on base or demands because certainly for perhaps on road vehicles because when those vehicles are growing, their drain interval is lengthening, the time you have to replace the lubes in the vehicles, and presumably that is happening in industrial applications as well. So to the extent that you agree with that view, that's I guess the first proper question. The second part is, how do you execute levers to add value in other areas as opposed to just the initial base oil profitability for [plants] that you [bought]?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, I think your statement regarding the drain intervals is correct, and it's the other end of the sword, if you will, of people upgrading their engine oils to higher-quality products like group 2 plus, group 3 type base oil derived engine oils. But I think one thing that we probably didn't do as good a job as we should have emphasizing in the Monday call in that we need to emphasize is this business that we are buying is more than just an engine oil company.

So a lot of the finished lubricants that we discussed on Monday, a lot of the specialty products that we discussed on Monday, obviously the white oil products that we discussed on Monday, they are not passenger car motor oil based. A lot of them are in differentiated markets such as natural gas engines, diesel engines, they are there for a very specific applications. Granted they are not of the size or scale of passenger car motor oils, but that's truly what differentiates Petro-Canada Lubricants is their R&D product development and salesforce orientation to continue to develop and find new markets and new applications like that to get an even better price and net back for the base oils than even the passenger car motor oil markets.

Ed Westlake - *Credit Suisse - Analyst*

Okay. Thank you very much.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Ed.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Hello, guys.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning.

Paul Cheng - *Barclays Capital - Analyst*

George, you were talking about wanting to grow the HEP. From that standpoint, have you guys whether that you need to restructure the GP and the LP to find a way that you permanently lower the HEP capital cost? One of your major competitors have been indicating that or actually a couple of them that indicate to do that. So I was wondering if that is something that in the near horizon that you guys would consider.

George Damiris - *HollyFrontier Corporation - President & CEO*

The short answer to that is, yes. So it's not the first time we've heard the question, obviously, Paul, and we think about that all the time. Even if we weren't looking at doing acquisitions at the HEP level. I think another comment we've made in the past along these regards is we don't have to do a complete structuring of the IDR. I think you saw an example of this when we did the unit drop from HFC to HEP that we can have some sort of temporary mechanism rather than a permanent IDR adjustment to facilitate the same deal.

Paul Cheng - *Barclays Capital - Analyst*

From that standpoint, do you think the other argument is that if you are going to merge the economic interests off the GP into the LP and in exchange for more LP unit normally a small clean cut but it also to allow you to have a public marker in terms of what is the value of the GP cash flow.

George Damiris - *HollyFrontier Corporation - President & CEO*

Okay, you're talking about the IP portion of the GP?

Paul Cheng - *Barclays Capital - Analyst*

No. I'm saying that to take the GP into two units. One is the operation controls you continue to keep 100%. The other one is the economic interest and that economic interest you are going to sell it back to the LP in exchange for more LP units.

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, Paul, all of those things that you are mentioning are on the table and we are open to all of those. And as we've said before, we will do whatever we think is the right thing to do from both an HFC and HEP perspective along the lines of the things you were talking about.

Paul Cheng - *Barclays Capital - Analyst*

And just kind of a timeline that you guys have in mind or that this is an open end discussion and variation inside the Company.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think what's going to drive it the most, Paul, is the individual opportunities that we see available to us in the market to do an acquisition in HEP.

Paul Cheng - *Barclays Capital - Analyst*

I see. Second question, real quick, wondering if you would be willing to share what is the EBITDA contributions from your Tulsa business for the last several quarters. First quarter, second, and third quarter, and also whether the Woods Cross expansion and upgrade, any EBITDA contribution in the third quarter?

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Okay, so first question was regarding Tulsa lubes EBITDA?

Paul Cheng - *Barclays Capital - Analyst*

Yes.

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Yes. I don't know if we want to get too specific on look backs. I think like we indicated on our Monday call, we will provide some additional detail and context going forward. But let us think about the historical quarterly breakdown, Paul, but I think for right now what we've said, we will stick with that. That business roughly $100 million per year of EBITDA. And then as far as the Woods Cross expansion, I don't think we have any further updates from what we've provided before.

We still expect that EBITDA contribution to be in the $80 million to $100 million per year range with the caveat that just like I just talked about for the third and fourth quarter, crude dips in the Rockies have tightened quite a bit but I think we've factored some of that in when we gave the guidance of $80 million to $100 million of EBITDA. And it might be a little bit tighter now than when we gave that guidance, but again, we're not trying to provide that guidance on a quarter-by-quarter basis so what we expect from that expansion, we're trying to give what we think that expansion will do for us over the long haul.

Paul Cheng - *Barclays Capital - Analyst*

All right. Totally understand. Just curious if there is a number you can share in terms of the actual contribution in the third quarter from the Woods Cross expansion.

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Yes, I don't have that number off the top of my head, and I don't know if, Julia, if you have something there if we need to get back to Paul later.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Yes, I think, Paul, it has only been up and running really in full obviously for the third quarter, so I would look to having more of an update on the specific contribution after we've seen it running for six months, and particularly without a turnaround going on also at that plant. So we will be providing more granularity but not just on one quarter's of operation when we've also had turnarounds and inventories to work off.

Paul Cheng - *Barclays Capital - Analyst*

All right, thank you.

Operator

Chi Chow, Tudor, Pickering, Holt.

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

Great. Thank you. There has been a lot of chatter about the upcoming need to build out crude gathering pipes in the Delaware basin. Your positioned there already at HEP, so how do you assess the opportunity and is this a core part of your growth strategy in midstream?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, I think that's one of the areas that we are excited about is the Permian and especially the Delaware, and that we are well-positioned within HEP to participate in that. I think from what little I've heard, Chi, in the market, I'm hearing numbers as high as 5 million barrels per day of production out of the Permian. That sounds extremely high to me.

There's no question that the Permian is one of the better basins and the Delaware is one of the better fields within that basin. But again, I don't follow this as much as other people do, but I think a lot of the chatter that I'm hearing is a lot more optimistic than I would tend to believe. But we still think that with production still around 2 million barrels a day now, we still think it's going to grow even in the $50 BTI crude environment, and like you said, we think we are well-positioned within HEP to find opportunities to participate in that gathering and transportation sector of the crude world.

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

What is your gathered volumes in the basin right now, and are you specifically seeing and going after opportunities to build out that system?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think nominally, we touch about 150,000 barrels per day in that area. Obviously, we run 100-ish at Navajo, and then as we've said in the past, we are moving most of the remainder from the Permian up to Cushing where we run it at our Mid-Con refineries. We are working with producers to better understand their production plans and to see where those plants fit with our existing HEP footprint to build more connections, Chi.

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

Okay. Thanks. Back on the Rockies, I'm a bit confused by the throughput guidance. You've expanded the Woods Cross plant yet you're just flattish from the sound of it going forward on throughputs. So are you making economic run cuts given the environment or how should we think about the incremental volume on the expansion when that comes through?

George Damiris - *HollyFrontier Corporation - President & CEO*

So again, we are running gas oil and think in terms of say 2,000 to 3,000 barrels per day of gas oil inventory that we're still working off, and when you equate that to crude roughly, roughly gas oil is about one-third of a crude barrel so that is 2 to 3 of gas oil equates to 6 to 9 of crude. So that is why that's one of the reasons why the crude rate has been less than you would expect. But again, the incremental barrel now that the black wax that we are expecting for the expansion, Chi, is not available. It again is a Syncrude barrel, and our incremental crude runs will depend on the Syncrude [diffs]. There are times where Syncrude trades at I'd say a $3 premium to WTI up in Canada, and when we see that type of diff, it's going to be difficult for us to run unless the Salt Lake or Vegas product margins drive us to run a Syncrude barrel with that type of differential.

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

All right, thanks. It's just been a struggle in the region lately. What needs to happen to get the results going there in your view, George?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think again, we're fighting the headwind, Chi, of low crude price. One of the regions that is hit the hardest by the low crude price is the Rockies as far as crude production goes. So we're not seeing that's the type of impact in Cushing barrels. Cushing is well supplied, and as we just talked about, the Permian is well supplied. But the area where we're seeing the most impact on our crude availability and crude pricing is in the Rockies. So a little bit of crude price could go a long way in helping us there.

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

Okay. Okay. Great, thanks. Appreciate it.

Operator

Jeff Dietert, Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning, Jeff.

Jeff Dietert - *Simmons & Company International - Analyst*

On your lubes strategy with the acquisition you've made, do you see further opportunity for consolidation within the lubes segment or do you feel like with this acquisition you've kind of optimized lubes relative to the rest of your portfolio?

George Damiris - *HollyFrontier Corporation - President & CEO*

No, that's one of the reasons why we like the Petro-Canada Lubricants deal is that it gives us a solid platform for more bolt-on or even step-up type of acquisition and growth. We think the lubes industry is very fragmented, and we think there are a lot of companies that would be logical candidates for us to add on to that platform.

Jeff Dietert - *Simmons & Company International - Analyst*

Good, and are there other downstream related business lines that you would consider for diversification and cash flows? Asphalt, for example, appears to have some federal and state funds supporting the demand outlook there. Any other business lines that you think are ripe for acquisition.

George Damiris - *HollyFrontier Corporation - President & CEO*

The one-word answer to that is, yes. But none them are as exciting to us or maybe especially me as lubricants. There are opportunities in the asphalt sector, like you said. We have a nice position within that asphalt sector, but I wouldn't call asphalt a growth industry. I wouldn't even begin to compare it to lubricants as far as how differentiated the product offerings are, how much growth potential there is for us to participate in that sector. I think one of the areas that we've talked about in the past that we are looking at and this is mostly driven by RINs to participate further downstream, it fuels marketing activity.

Jeff Dietert - *Simmons & Company International - Analyst*

Okay, and you talked about very manageable maintenance capital within the lubes business. Is there an opportunity for growth capital there or do you see that more in the consolidation and bolt-on type opportunities within lubes.

George Damiris - *HollyFrontier Corporation - President & CEO*

No, we're very excited about the opportunity to deploy some capital within Petro-Canada Lubricants. And again, this is not meant to disparage the prior owner of that business that at the end of the day, the prior owner is a large Canadian crude producer first and foremost. Second, they had their refining business, and third, probably in that pecking order for capital allocation, was Petro-Canada Lubricants. I think it's safe to say that they will have a higher priority where we see a little capital within HollyFrontier than they have had as part of their existing ownership. So we think there are some pent-up demands for capital that will have great returns within Petro-Canada Lubricants.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks, George. Thanks, Jeff.

Operator

Neil Mehta, Goldman Sachs.

Neil Mehta - *Goldman Sachs - Analyst*

Good morning, everyone.

George Damiris - *HollyFrontier Corporation - President & CEO*

Hello, Neil.

Neil Mehta - *Goldman Sachs - Analyst*

George and Doug, two easy housekeeping questions. First, what were RINs cost in the quarter in dollar millions basis? And then the tax rate in the quarter seems a little low. Anything funky going on there?

George Damiris - *HollyFrontier Corporation - President & CEO*

I will take the RINs and then let Doug take the tax question because it's harder. The RINs I think we said we've spent $63 million on RINs in the third quarter.

Neil Mehta - *Goldman Sachs - Analyst*

Okay.

Doug Aron - *HollyFrontier Corporation - EVP & CFO*

Yes, so on taxes, Neil, we came in at about 20% for the quarter, and that was obviously lower than a statutory rate for a couple of reasons. One is just lower expected earnings for the fiscal year, and then secondarily, a higher percentage of our earnings coming from HEP and the tax advantage structure there. I think we are seeing that as a pretty common theme across the refining space in the third quarter, no exception at HollyFrontier.

Neil Mehta - *Goldman Sachs - Analyst*

Makes a lot of sense. A follow-up on the HEP logistics M&A point. It seems like that's where some of the focus is shifting from an acquisition standpoint. How do you think about corporate level M&A versus asset level? Is there a distinction there or would you be open to either? And do you think -- as you think about ultimately where to execute a potential transaction at the HEP level versus the HFC level, how do you think about that?

George Damiris - *HollyFrontier Corporation - President & CEO*

Well, the first question corporate versus asset. We are open to either. And I think with the caveat that typically it's little bit easier to do an asset deal than a corporate deal but that's a minor nuance. The higher level question is that we are open to either. Then as far as where to execute, I'm a little bit not sure what you're getting at there, Neil, but my top of the head answer there is that it seems like we're going to do something in logistics. It's logical to do it at HEP rather than HFC corporate.

Neil Mehta - *Goldman Sachs - Analyst*

Yes, make sense. All right. Thanks, guys.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Neil.

Operator

Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Hello, guys. Appreciate that you have answered a lot of the questions already. I noted particularly, George, that you -- that this is more of an inspirational target than a concrete target, so I realize that it's more conceptual. Just on the balance sheet, did you say that you -- how for can you go with that? Can we just re-clarify how far you are prepared to take your debt levels in order to accomplish this goal?

George Damiris - *HollyFrontier Corporation - President & CEO*

Well, I hate getting too concrete on that, Paul, but I will offer up 2 times EBITDA for the right deal.

Paul Sankey - *Wolfe Research - Analyst*

Yes.

George Damiris - *HollyFrontier Corporation - President & CEO*

Then again with the concerted effort to get it back to the 1 times level.

Paul Sankey - *Wolfe Research - Analyst*

Yes. I think I heard that earlier. And again, it's conceptual, but you just expanded into petchems. I think what you're saying is you would like to keep going in petchems. Is that fair if you can find the right deals? I mean I'm wondering whether or not you have doubled petchems and then you are gong to double everything else or whether you --.

George Damiris - *HollyFrontier Corporation - President & CEO*

No, we've -- these visions always create a lot of discussion, and I'm glad that it did. But at the risk of creating more confusion and unwarranted discussion, there's still four years left between now and 2020, and because we never rest on our laurels at HollyFrontier, we've reset the lubricants growth target to double again by 2020. Because to not reset it would mean that we're happy with where we are and we're never happy with where we are.

Paul Sankey - *Wolfe Research - Analyst*

Okay, and then I think on maybe just the previous answer -- one of the obvious areas to grow would be the retail in terms of RINs coverage, but at the same time you were earlier saying that you think you can get there on points of obligation. Were you saying that you would want to expand in retail?

George Damiris - *HollyFrontier Corporation - President & CEO*

I would say it's an area that we are looking at and evaluating. But honestly, it would be a tough thing to do from a grassroots level, so it would be something that would have to come through an acquisition.

Paul Sankey - *Wolfe Research - Analyst*

Yes, I get it. And are you going to be planning a meeting? I mean obviously, we appreciate that you've come in subsequent to the analyst meeting where it was all about buyback and your new CEO. Are you planning any sort of analyst meeting or formal event for us to go through all of this?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the short answer to that is no, but I think we've been thinking about it, and if we do one, it will probably be next September, which would mark the two-year anniversary from the last one.

Paul Sankey - *Wolfe Research - Analyst*

Great. Okay. Thank you.

Operator

And thank you. At this time, I would now like to turn the commerce back over to Julia for any closing remarks.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Thanks, everyone, for joining us today in addition to joining us on Monday. I know it's been a busy -- (inaudible). We look forward to sharing our full-year results which will be announced at the end of February. Of course, there is always Investor Relations available for any follow-up questions you might have throughout the day. Thanks. Have a good day.

Operator

This does conclude today's conference call. Please disconnect your lines at this time and have a wonderful day.