

08-Aug-2022

HF Sinclair Corp (DINO)

Q2 2022 Earnings Call

CORPORATE PARTICIPANTS

Craig Biery

Vice President-Investor Relations, Holly Energy Partners LP

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

OTHER PARTICIPANTS

Manav Gupta

Analyst, Credit Suisse Securities (USA) LLC

Paul Y. Cheng

Analyst, Scotiabank

Theresa Chen

Analyst, Barclays Capital, Inc.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

Matthew Blair

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Jason Gabelman

Analyst, Cowen & Co.

John M. Royall

Analyst, JPMorgan Securities LLC

MANAGEMENT DISCUSSION SECTION

Operator: Welcome to the HF Sinclair Corporation and Holly Energy Partners Second Quarter 2022 Conference Call and Webcast. Hosting the call today is Mike Jennings, Chief Executive Officer of HF Sinclair and Holly Energy Partners. He is joined by Rich Voliva, Executive Vice President and Chief Financial Officer of HF Sinclair and President of Holly Energy Partners; Tim Go, President and Chief Operating Officer of HF Sinclair.

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

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

Craig Biery

Vice President-Investor Relations, Holly Energy Partners LP

Thank you, Rick. Good morning, everyone, and welcome to HF Sinclair Corporation and Holly Energy Partners second quarter 2022 earnings call. This morning we issued press releases announcing results for the quarter ending June 30, 2022. If you would like a copy of the press release, you may find them on our website at hfsinclair.com and hollyenergy.com.

Before we proceed with remarks, please note the Safe Harbor disclosure statement in today's press releases. In summary, it says statements made regarding management expectations, judgments or predictions are forward-looking statements. These statements are intended to be covered under the Safe Harbor provisions of federal

security laws. There are many factors that could cause results to differ from expectations, including those noted in our SEC filings.

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

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

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Great. Thanks, Craig. Good morning, everyone. Today we reported second quarter net income attributable to HF Sinclair shareholders of \$1,221 million or \$5.43 per diluted share. These results reflect special items that collectively decreased net income by \$37 million. Excluding these items, adjusted net income for the second quarter was \$1,259 million or \$5.59 per diluted share as compared to adjusted net income of \$144 million or \$0.87 per diluted share for the same period in 2021. Adjusted EBITDA for the current quarter was \$1.9 billion, an increase of [ph] \$1.5 billion (00:03:05) compared to the second quarter of 2021.

Our second quarter results reflect the combined benefits of an improved global economy and demand picture, refined product and lubricant supplies that are constrained by the actions taken in response to both the COVID-19 pandemic and sanctions due to the Ukraine conflict and our successful and countercyclical acquisitions of the Puget Sound refinery and the Sinclair assets.

To date, we have achieved annualized run rate synergies of over \$90 million related to the Sinclair acquisition and over \$100 million of working capital synergies. We're on pace to exceed our target of approximately \$100 million in annual run rate synergies within two years of the acquisition closed date through a combination of commercial improvements, operating expense reductions, and SG&A optimization.

We also announced today that our Board of Directors declared a regular dividend of \$0.40 per share payable on September 1, 2022 to holders of record on August 18. During the quarter, we returned over \$200 million to shareholders through dividends and share repurchases. We repurchased 2.7 million shares of common stock, totaling \$132 million in connection with our share repurchase program. As of June 30, 2022, we have remaining authorization to repurchase up to \$868 million under this stock repurchase program, and we expect to remain active throughout the second half of 2022.

We remain fully committed to our capital allocation strategy of returning \$1 billion to shareholders no later than first quarter of 2023, while maintaining our solid balance sheet and investment-grade rating. Heading into the second half of the year, we're constructive on the outlook for transportation fuels supported by low product inventories and healthy global demand. Looking forward, we will continue executing our strategic initiatives. We remain focused on the integration of our recently acquired assets from Sinclair, while maintaining safe and reliable operations. We see great value with the DINO brand as we look to grow the marketing segment within our existing geographies.

With all of our previously announced renewables program – projects complete, we will continue to ramp up production of these assets as we expect to reach full production levels by the end of the third quarter of 2022. As one of the largest producers of renewable diesel, we are excited about the opportunity of providing low carbon fuels to our customers, while realizing the incremental earnings uplift from our investments.

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

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Thank you, Mike. Let's begin by reviewing HF Sinclair's financial highlights. As previously mentioned, the second quarter included a few unusual items. Pre-tax earnings were negatively impacted by a lower of cost to market inventory valuation adjustment of \$35 million, acquisition integration costs of \$13 million, and decommissioning charges of \$0.5 million related to the Cheyenne Refinery conversion to renewable diesel production. A table of these items can be found on our press release.

Net cash provided by operations totaled \$1.5 billion, which included \$25 million of turnaround spending and \$33 million of cash sourced from working capital. HF Sinclair's standalone capital expenditures totaled \$150 million for the second quarter. As of June 30, 2022, HF Sinclair's total liquidity stood at approximately \$3.3 billion comprised of a standalone cash balance of \$1.7 billion, along with our undrawn \$1.65 billion unsecured credit facility.

On June 30, we had \$1.74 billion of standalone debt with a debt to cap ratio of 16% and a net debt to cap ratio of 1%. HEP distributions received by HF Sinclair during the first quarter totaled \$21 million. HF Sinclair owns 59.6 million HEP limited partner units which, following the acquisition of Sinclair Transportation, represents 47% of HEP's outstanding LP units, a market value of \$1 billion as of last Friday's close.

Let's go through some guidance items. We have reduced our expected capital guidance for 2022 to the range of \$785 million to \$950 million. We now expect to spend between \$225 million and \$250 million in refining, between \$250 million and \$300 million in renewables, \$45 million to \$60 million at lubes and specialties, \$15 million to \$25 million in marketing, \$90 million to \$110 million in corporate, and \$110 million to \$130 million for turnarounds and catalysts. At HEP, we expect to spend \$50 million to \$75 million in total capital.

With respect to tax, we received \$83 million in cash during the second quarter of 2022 under the loss carryback provision in the CARES Act. Going forward, the HF Sinclair corporate tax rate is expected to be in the range of 19% to 21%. For the second quarter of 2022, we expect to run between 630,000 and 650,000 barrels per day of crude oil in our refining segment. We have no major turnarounds at our fuels refineries scheduled for the remainder of 2022.

Turning to Holly Energy Partners. Second quarter net income attributable to HEP was \$56.8 million compared to \$55.7 million in the second quarter of 2021, which included a \$5.3 million gain related to a refined pipeline sale. Excluding this gain, net income was \$50.5 million for the second quarter of 2021. The year-over-year increase was primarily attributable to earnings related to the recently acquired Sinclair Transportation assets, partially offset by higher interest expense and operating costs.

HEP's second quarter 2022 adjusted EBITDA was \$104.2 million compared to \$88.3 million in the same period last year. A reconciliation table reflecting these adjustments can be found in HEP's press release. HEP generated distributable cash flow of \$78.5 million and we announced the second quarter distribution of \$0.35 per LP unit, resulting in distribution coverage ratio of 1.8 times. This distribution is to be paid on August 12 to unitholders of record as of August 1.

During the second quarter, HEP total capital expenditures were approximately \$15 million, including \$7 million in turnaround expenses related to our Woods Cross refineries and processing units, \$5 million of maintenance CapEx, \$2 million of reimbursable CapEx and \$1 million in expansion of capital. For 2022, our capital expenditure forecast was revised slightly to \$50 million to \$75 million.

Looking forward, HEP remains committed to our capital allocation framework as we continue to reduce leverage using retained cash flow. We are on track to achieve our short-term leverage target of 3.5 times by year-end and we expect to increase unitholder returns in 2023.

And with that, Rick, we're ready to take questions.

QUESTION AND ANSWER SECTION

Operator: The floor is now open for questions. [Operator Instructions] Thank you. Our first question comes from Manav Gupta with Credit Suisse. Your line is open.

Manav Gupta

Analyst, Credit Suisse Securities (USA) LLC

Q

Hey, guys. Congrats on this countercyclical strategy of buying assets. I know you got a little pushback earlier on it, but clearly it's delivering results. My question here is, now you have operated Sinclair assets for a quarter; clearly, you like what you see, you're kind of indicating to higher synergies. So talk [indiscernible] (00:12:00) what were the positive surprises of the Sinclair acquisition and maybe one area where you thought it would be stronger and more work is needed at this stage?

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

A

Manav, this is Tim. I'll start with maybe some specifics and then let the group talk about at a little higher level. We were very pleased with the Sinclair assets and especially the Sinclair employees over this last quarter of working together. I think one pleasant surprise was the synergies or the logistics opportunities that we've been able to see, both on the crude side and on the product side, has led to us running higher throughput rates at Woods Cross and Casper than either site could have run separately. So I think that's been exciting. We've sent monthly records at both locations, and it's only because of the employees working together through the logistics assets to be able to accomplish that.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

Manav, beyond that, we're super excited about this brand and the opportunity to be more vertically integrated in terms of our product distribution. You asked specifically for something where we haven't fulfilled our hopes and dreams yet, and I'll say it's there. We have a lot to do and a lot of opportunity within branded distribution. And we are adding stores, we see opportunity within our existing refining footprint, and that's really where a lot of work is going to be as we look forward is converting this downstream distribution from wholesale rack to more of a branded approach, and then there's plenty of opportunity in front of us.

Manav Gupta

Analyst, Credit Suisse Securities (USA) LLC

Q

Perfect. My quick follow-up here is, another very strong quarter for the Rack Forward business. Help us understand a little bit about the dynamics which are driving this strength? And also like what's your vision for the entire lubes business? Are you looking to grow it? Are you happy with the footprint you have? If you could talk a little bit about those things.

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

Yeah. Manav, this is Tim, again. I'll start specifically talking about the Rack Forward business and then I'll let Mike finish up with your broader question. We had another strong quarter – record quarter for lubes, as you pointed out. Despite the Rack Back or the increase in prices in base oils, our Rack Forward business has been able to keep up which has been encouraging.

A couple of things that we've talked about over the last year that are really starting to play out is SKU rationalization and upgrading our product mix that I think is really driving the improved results that we're seeing. SKU rationalization, we're up to 20%, 25% of SKUs that we're able to simplify the business, take cost out, lower working capital, reduce carrying costs. All of that is driving us to better synergies or better efficiencies. Better yields and upgrading our product mix is also helping us as we continue to focus on processed oils and specialties businesses versus the passenger car, motor oils, for example.

You're also seeing better integration between our feedstocks coming from our Tulsa refineries, tying to our finished lubes business with petroleum with [indiscernible] (00:15:33). So, all three of those really are contributing to these stronger results.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Manav, from a little higher level as to whether we consider this to be core or not, we absolutely do. We think we can grow it and we like the business. At the same time, we [indiscernible] (00:15:50) take note of external markers, particularly Valvoline transaction, and we're pragmatic about this business and any other that we own in terms of inside versus outside valuation. But for the time being, we see a lot of meat on the bone here and we think we can grow this business.

Manav Gupta

Analyst, Credit Suisse Securities (USA) LLC

Thank you for taking my questions and congrats on a great quarter.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Thank you.

Operator: Your next question comes from Paul Cheng of Scotiabank. Your line is open.

Paul Y. Cheng

Analyst, Scotiabank

Hey, guys. Good morning.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Hi, Paul.

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Hi, Paul.

A

Paul Y. Cheng

Analyst, Scotiabank

[ph] On my end, Rich, said (00:16:22) at the time when you set the capital return of \$1 billion compared to today certainly second quarter and third quarter look like it was much stronger than you expected. And so, when you're looking at that number, what will be the criteria or consideration [ph] for you to raise (00:16:45) that number? That's the first question. Maybe then, I will [ph] weigh into your (00:16:50) answer, then I will go for the second one.

Q

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Yeah. Paul, this is Rich. Good morning. Look, I think we're very comfortable that we will achieve that number. At this point, we'd expect to get there no later than the first quarter. Just to put a little more color around that. As Mike mentioned, we did 2.7 million shares in the second quarter. We did another 3 million shares for about \$130 million in July. We've got dividends to pay. So, we expect that we're running comfortably toward that number. To your point about increasing it, let's see how the market goes here, but we're optimistic at this point.

A

Paul Y. Cheng

Analyst, Scotiabank

But Rich, can you share with us that what will be the criteria that you need to achieve in order for you guys to say, oh, yeah, I mean that we can raise that distribution; and any kind of matrix that you can share or anything.

Q

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

So Paul, I don't know if I can give you a matrix. I have been doing this a long time. We know how volatile these markets can be. We'd rather speak less and deliver more.

A

Paul Y. Cheng

Analyst, Scotiabank

Okay. And maybe this is for Tim. The West region margin realization was very good and much stronger than we thought. Just curious that is there any one-off benefit in the quarter or that we can say, oh, mainly just because their overall margin is good and you capture that. And if we have a similar margin again, you will capture it again.

Q

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

Yeah, Paul. This is Tim. Not a whole lot of one-offs. Really we saw exceptional margins cracks in the Pacific Northwest, as well as in the Rockies that obviously helps. But this was the first quarter that we had Puget Sound running at full utilization and that helped significantly in the capture.

A

Mike talked about the Sinclair synergies that we're able to identify and to capture. That helped in our capture there as well. And then as margins go higher, the RINs contribution or the RVO contribution becomes less in terms of percentage-wise. That helped us in the capture on the West as well. So, I don't really see any major one-offs to point out, Paul.

Paul Y. Cheng

Analyst, Scotiabank

Okay. Great. Thank you.

Q

Operator: The next question comes from the line of Theresa Chen at Barclays. Your line is open.

Theresa Chen

Analyst, Barclays Capital, Inc.

Good morning. I wanted to ask first on the midstream strategy from [ph] zero (00:19:41). So, as we long spoke about the – you're bucking the trend versus what many of our competitors are doing with their sponsored MLPs choosing to roll them in over time. There's been acceleration of this kind of activity over the past year or so. In contrast, today, talking about increasing unitholders for HEP in 2023.

Q

So first part of the question is, just an update on your general midstream strategy and what underlies your decision to keep HEP outstanding versus when – would it be compelling to forward in? And then related to the higher unitholder returns, how do you envision this happening? Would it be through distribution increases, buybacks or special distribution? Love to hear more detail here.

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Hey, Theresa. It's Rich. Good morning. So I'd say, look, first HEP is critically important to HF Sinclair. The ownership of those assets is critical to our refining business and we've got an outstanding team operating those assets. So we do see opportunities to grow that business both with HF Sinclair and outside of HF Sinclair.

A

To your question about the financial structure, really to us that's a corporate finance question. And so far, a rollup has not made sense from that perspective. It's probably worth pointing out here that HEP is relatively large relative to HF Sinclair, and that affects any sort of per share math they might do. So look, we'll continue to monitor the situation and do the best thing to create value for all of our shareholders.

Looking to 2023 to your question about distribution growth, at this point I think we would urge increasing the distribution itself. We'll evaluate buybacks. As you know, HEP is not the most liquid stock, so it's not necessarily that we want to reduce the flow. It may not be in the best interest of HEP, but if that's a better option, we'll go ahead and do it. But right now, I'd say, it's going to take the form of distribution increases.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

I'll add to that, Theresa, simply that we put a lot of capital towards external growth via acquisitions. And at this point, incremental capital is to be returned to HF Sinclair shareholders in the near term as compared to buying in a related MLP. All that Rich said in terms of its ownership and the criticality of it is quite true. But in terms of capital allocation, really it goes to HF Sinclair holders first.

A

Theresa Chen

Analyst, Barclays Capital, Inc.

Thank you.

Q

Operator: Your next question comes from the line of Doug Leggate. Your line is open.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Q

Hey, good morning, everyone. Mike, I wonder if you can offer an opinion on the recent restructuring of some of the MLP ownerships we've seen from Phillips 66, from Shell, from PBF. And you're obviously one of the last man standing, so to speak, along with Marathon. What are you thinking in terms of, now you've got your balance sheet back to pristine shape and the relative yields obviously being what they are? How do you think about the logic of continuing that ownership structure?

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

Yeah. Doug, I tried to head that off in my last comment, but let's just put it on the table. We took a pause of a dividend for one year. We made two different acquisitions which we consider to be really high value. And at this point, we intend to pay our shareholders back for their patience and that – in those investments.

So, that basically says that in the near term we're most interested in returning capital to HF Sinclair shareholders. What our peers do? As Rich was insinuating, a lot of that probably depends a lot on the relative size of those entities versus the size of the mother ship. Take Shell, BP as examples. In our case, it's relatively larger. And we'll do the math, of course, but buy-in would need to be accretive to cash flow and earnings. And for the time being, we're allocating our capital otherwise.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Q

I know it's probably too obvious of a question, Mike, but I appreciate your perspective. I guess, I don't think anyone's really asked on the macro yet. So, I wonder if I could really just get your kind of current views, given that gasoline seem to have rolled over pretty hard and obviously diesel holding in there spreads a little bit wider. What are you seeing halfway through almost the third quarter? What are you seeing in terms of the trends there? Maybe any insights you can offer as to how your quarter is going so far? And then of course, the inevitable question on gasoline demand destruction, what are you seeing in your system? And I'll leave it there. Thanks.

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

A

Yeah, Doug. This is Tim again. Let me start with some of the direct responses to your demand questions and then I'll let Mike weigh in on more of the macro. We're still seeing strong demand in our regions coupled with high utilization. It's still resulting in product inventories being below five-year averages. So, that's all very constructive and very positive in the areas we operate. Diesel in particular is at or above 2019 demand levels. We feel good about that. Gasoline strong specifically in the Southwest, but we would say probably within 5% of our 2019 levels. So we're continuing to see good strength there.

I would also mention that on the marketing side, Mike mentioned that at the beginning. We're continuing to see strong demand for our brand. We added 20 retail sites here in the second quarter. We've added more than 50 in progress still as we look to expand the Sinclair brand into some of these new markets. So from a marketing standpoint, we're continuing to see strong pull there as well.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Q

Thanks, Tim.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

A little bit more on that. I think that in early July, late June, there was clearly some price elastic demand, right? And I think that the industry saw a little bit of falloff. We don't see anything like the sort of 10% that's implied in the DOE aggregate demand numbers. And so, our markets just aren't seeing that kind of behavior. More than that, I think that this product is now traded the rack at \$2.50, \$2.75 range and adding excise taxes, retail distribution costs. You're not much above 2021 levels. So, expectation is given that the strong economy, the labor numbers that we're seeing that that price elastic demand probably comes back pretty quickly.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Q

Guys, I [ph] hit the label of (00:26:40) the point, but do you have an explanation as to why the [ph] EIA data (00:26:42) is showing what it's showing? Any thoughts on that?

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

No. No. We're happy to see it every Wednesday.

Doug Leggate

Analyst, Bank of America Merrill Lynch

Q

Thanks, fellas. Appreciate the answer.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

Take care.

Operator: The next question comes from the line of Neil Mehta with Goldman Sachs. Your line is open.

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

Q

Hey, guys. Good quarter here. Thanks. Thanks for taking the time. The first question is on just on renewable diesel. In a set of strong results, renewable diesel was the outlier, came a little bit softer this quarter. So just talk about how you see margins are tracking and the outlook for the rest of year. And then also talk about the Blender's Tax Credit and the extension thereof, because that could support the long-term profitability of the business. Thank you.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

Certainly. Neil, the renewable diesel margins and earnings really reflect low throughput as much as anything. Recognize that our Artesia RDU project is just coming on-stream now and just in this quarter beginning to gain revenue from its sales. So, low throughputs, poor utilization and relatively high feedstock cost with respect to RBD, and I think this is on the heels of the Ukraine sort of disruption in veg oil economies, if you will.

But as you know, we've invested in a pretreatment unit. And while we initially bought a lot of RBD to feed our start-ups, we're progressing toward a diverse feedstock slate much of which is going through our own PTU, and

that will significantly improve our economics. As of today, for example, the [indiscernible] (00:28:32) versus RBD spread per gallon is something like \$0.75. So as you can see, that's a significant uplift in margins.

Looking forward, in terms of what we have, we've called out that the third quarter is still a ramp period for our production because Artesia is really very much still in start-up and expects to achieve full rate by the end of the quarter, but not through the quarter. So, that's going to be a little bit of a headwind in terms of earnings performance. But otherwise, feedstock costs and margins are in our favor here. So, we're still very constructive on the investments that we've made. And what I'd say is, it's utilization and start-up more than anything else that's affected margins.

As to BTC Inflation Reduction Act, yes, that solidifies the margin outlook certainly through 2024; and thereafter, as you know, it converts to a clean fuels or sort of an [ph] LCF/FCI (00:29:33) driven contribution in terms of that credit. But that provides some certainty in terms of the producer's margins and makes this all more optimistic. Our initial economics anticipated the BTC expiring through – at the end of 2022. Now, we've got two years of very solid expectations and then a CI-based benefit after that.

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

Q

Okay. That makes sense, sir. And the follow up is just around the crude side of the equation. With fewer turnarounds in the back half of the year, it's good timing with some widening of both Brent/WTI and then also TI/WCF. How do you think about the sustainability of those wider differentials? And is that just a reflection of SPR, or is there something underlying in the transport economics that would support the wider spreads?

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

A

Yeah. Hi, Neil. It's Tim. Yeah. Certainly, the SPR is impacting the Brent/TI spread. I think strong Permian production is also providing a very stable volumes coming out from a WTI perspective. But if you look on the Brent side, we've got some uncertainty there. Higher natural gas in Europe certainly driving more demand and making Brent a little bit more scarce. You got the Russian crude embargo that's creating a drive for those Brent barrels.

So I think, while we normally think of the transportation basis between Brent/TI in that [ph] \$3 to \$3.50 (00:31:08) range, right now transportation is not setting the spread. We think that spread is being set by the scarcity in the Brent side. And we think really, if you look at kind of the dynamics that are driving that, it's probably not going to change anytime near term. So you look at the forward strip, you see the Brent/TI spread kind of in that \$5 to \$6 range, we think that's what's going to happen here over the next couple of years. It's a good time to obviously be long on refining and have additional in-land crude refineries in our portfolio.

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

Q

And Tim on WTI/WCS?

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

A

Yeah. On the WCS spread widening that again, you may have noticed that we ran more WCS in the second quarter than we have in previous quarters. That's taking advantage of that spread. We think there is more to be

able to take advantage of in the third quarter. You see some of the maintenance that was occurring up in Canada complete, some of the production coming back online, and starting to fill out the pipeline takeaway capacity.

We think, by the end of the year we're going to start seeing pipelines being allocated again and we think that's going to put some pressure again on that WCSMTI spread. So we think that's sustainable. Really as we look at our forecasts, we think that allocation is going to come back here for a while and we're going to be able to enjoy those spreads.

Neil Mehta

Analyst, Goldman Sachs & Co. LLC

Thank you, guys.

Q

Operator: The next question comes from the line of Matthew Blair with Tudor, Pickering, Holt & Company. Your line is open.

Matthew Blair

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Hey. Good morning. Congrats on the result. The marketing profitability was better than we were expecting. Can you talk about the drivers here and how things are progressing in the segment so far in Q3?

Q

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

Yeah, Matt. This is Tim. Our new branded marketing segment, as Mike pointed to earlier, is performing better than we expected and that's all very encouraging. We're seeing a lot of traction on our Sinclair brand. As I mentioned before, we've added 20 retail sites here just in the second quarter alone. We've got another 50 that are in progress here that we think we'll be able to bring in here before the end of the year. Growth targets, we're hoping in that 5% to 7% growth range is what we're looking at, and we think can be very reachable.

A

Our strategy is, we have several licensed retail sites as you guys have seen in our previous disclosures. Clearly, if we can convert some of those licensed sites into supplied sites, that'd be a good place to start and we are doing that right now. Some of our new markets where our legacy HollyFrontier assets have been at Southwest region and the PNW region, we're seeing a lot of interest and growing the Sinclair brand there.

And then lastly, in our mature markets in the Rockies where we have the Sinclair brand already well-established, we're seeing a lot of incremental pull to continue to grow there as well. So, a very exciting time for us, Matthew, and we think that branded business is going to be important for our portfolio in the long term.

Matthew Blair

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Sounds good. And then, could you talk about the geographical end markets for your RDU production today? Do you rail all that to California, or have you found other markets that are equally as appealing?

Q

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Yeah. We won't be specific as to quantities, but we're working through the Western states as well as Canada, and then trying to find best value but pursuing markets throughout those areas, not just California.

A

Matthew Blair

Analyst, Tudor, Pickering, Holt & Co. Securities, Inc.

Great. Thank you.

Q

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Yeah.

A

Operator: The next question comes from the line of Jason Gabelman with Cowen. Your line is open.

Jason Gabelman

Analyst, Cowen & Co.

Hey, good morning. Thanks for taking my questions. First, just maybe as we think about the buyback moving forward. It'd be helpful just if you could remind us your targets for the balance sheet in terms of both debt and cash levels? And maybe a couple of other modeling-related questions. What's your SGA on a go-forward basis? And then, is this quarter's West refining region OpEx indicative of where you expected to be on a go-forward basis? Thanks.

Q

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

Hey, Jason. It's Rich. So with respect to the balance sheet and the repurchase, let's start from a balance sheet debt perspective, we're very committed to our investment-grade rating. We've been guided to sort of 3 times debt to EBITDA at a trough or 2 times mid-cycle is the metric we got to look at in the consolidated leverage. You'll note, we're there, we're inside of that right now, so we've got capacity. So there's no need to preserve cash to repurchase or repay debt at this point. We continue to look at \$500 million as our sort of minimum or target cash balance, and we've got plenty of dry powder, if you will, for share repurchase at this point.

A

SG&A, I think if you make some adjust – the appropriate adjustments to 2Q for M&A costs that we called out here, it's a good run rate. And then with respect to the West operating expenses, I think this quarter's a good run rate.

Jason Gabelman

Analyst, Cowen & Co.

Great. Thanks.

Q

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

[indiscernible] (00:37:06) a big flywheel there.

A

Jason Gabelman

Analyst, Cowen & Co.

Yeah. Got it. Understood.

Q

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

A

Couple of things to call out on the West to add to Rich's comments. Natural gas just continues to be elevated. We've got some bonus accrual impacts as well. But we did have some planned maintenance at Puget Sound and at [ph] Rollins (00:37:27) that maybe a little bit higher than normal. So we're looking to bring that down looking forward.

Jason Gabelman

Analyst, Cowen & Co.

Okay. Understood. Any way to quantify that for the quarter?

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

No. No. Those are puts and takes to be honest. So, I don't think it's going to be a big driver at the end of the day. Natural gas again, being the one thing that we can't forecast that can really move that number around.

Jason Gabelman

Analyst, Cowen & Co.

Got it. And then my other question, just on the renewable diesel business. As we think about the ramp up, you mentioned you're running RBD now just in the early portion of the production of the platform. But as you get the pretreatment unit up, how much RBD do you expect to run once this platform is fully up and running in 4Q? Thanks.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Yeah. That will be obviously dependent on economics, but I'd say, less than half or around half depending on RBD versus [indiscernible] (00:38:40) and other economics.

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

So Jason, let me add some math there. Our pretreatment capacity, kind of pro forma the transaction and everything will be, call it, 50-plus percent of our renewable diesel production and then we do have the ability to run some other feeds straight into the unit as well. So we've got the flexibility to run 60-plus percent [ph] in non-RBD (00:39:06). As Mike mentioned, right, this is all going to be economics driven at the end of the day though.

Jason Gabelman

Analyst, Cowen & Co.

Okay. Great. Thanks for the answers.

Operator: Your next question comes from the line of Paul Cheng, Scotiabank. Your line is open.

Paul Y. Cheng

Analyst, Scotiabank

Hey, guys. Thank you. Just two quick follow-ups. Maybe Tim can do – help us understand the dynamic in the marketing gross margin, \$0.07 per gallon in this quarter. I mean, how much is the fluctuation or seasonality in that business [indiscernible] (00:39:40)? So trying to have a better understanding on that.

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

Yeah. Paul, the gross margins of \$0.07 is higher than what we had guided to when we originally put out the Sinclair performance. We're pleased with that. We're seeing again strength in branded businesses. As you see higher gasoline prices and higher demand, I think we are seeing a widening of that spread between branded and unbranded. Don't know yet. We don't have enough experience to know if that's going to be sustainable or not. But we think it's real and we've seen it. And we continue to look for that strength here in the third quarter.

Paul Y. Cheng

Analyst, Scotiabank

Maybe Tim, let me ask in another way. In the contract that you signed with [indiscernible] (00:40:33), are those sort of more [ph] like a (00:40:37) fixed margin or that is a rack price plus whatever is the additional margin churn to understand that how the pricing on those contract are?

Timothy Go

President & Chief Operating Officer, HollyFrontier Corp.

Yeah. No. We don't sign up for any fixed prices there, Paul. It's all really based on a posted price and that's how we work with [indiscernible] (00:41:02) on that.

Paul Y. Cheng

Analyst, Scotiabank

Thank you. And just curious that – maybe that this is for Mike. I think in the past you have said that you have no interest getting into the retail business that you own the store directly and [indiscernible] (00:41:20). Any change in that thought now that you have the brand marketing?

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

No, there is no change in that thought, Paul. That's a very different skillset staffing level. We intend to be branded wholesalers. We want to manage the brand. We want to add volume to that distribution channel and support those retailers with a strong branded presence, but that's our contribution.

Paul Y. Cheng

Analyst, Scotiabank

All right. Thank you.

Michael C. Jennings

Chief Executive Officer & Director, HollyFrontier Corp.

Yeah.

Operator: The next question comes from line of John Royall with JPMorgan. Your line is open.

John M. Royall

Analyst, JPMorgan Securities LLC

Hey. Good morning, guys. Thanks for taking my question. Most of mine was asked, I just had one. So just looking at your mid-cycle adjusted EBITDA guidance, you have \$1.35 billion for refining. I'm just wondering, I know the

synergies are pointed a bit upwards from what you had guided there. But just generally, anything about this environment that you think is sticky where maybe the \$1.35 billion number is biased upwards?

Richard L. Voliva III

Chief Financial Officer & Executive Vice President, HollyFrontier Corp.

A

Hey, John. It's Rich. I'd say, the one thing that we'd point to is, you'll notice from the build up to that number, we get there by taking Gulf Coast cracks's rate and in crude differentials, adding product differentials. I'd say, we probably feel better about the product differentials in our markets structurally than is reflected there. So we do think there's probably some upside from that perspective.

Rockies, in particular, right, there's a market where you've got very good demographics and economic growth and you've got very constrained supply just doing the geography itself. There's really not much opportunity to substitute petroleum fuels there. So that's a place that we do see upside to that mid-cycle buildup.

John M. Royall

Analyst, JPMorgan Securities LLC

Q

Hey. Thanks very much.

Operator: There are no further questions at this time. Craig, I turn the call back over to you.

Craig Biery

Vice President-Investor Relations, Holly Energy Partners LP

Thanks, everyone. We appreciate you taking the time to join us on today's call. If you have any follow-up questions, just always reach out to Investor Relations. Otherwise, we look forward to sharing our third quarter results with you in November.

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

Disclaimer

The information herein is based on sources we believe to be reliable but is not guaranteed by us and does not purport to be a complete or error-free statement or summary of the available data. As such, we do not warrant, endorse or guarantee the completeness, accuracy, integrity, or timeliness of the information. You must evaluate, and bear all risks associated with, the use of any information provided hereunder, including any reliance on the accuracy, completeness, safety or usefulness of such information. This information is not intended to be used as the primary basis of investment decisions. It should not be construed as advice designed to meet the particular investment needs of any investor. This report is published solely for information purposes, and is not to be construed as financial or other advice or as an offer to sell or the solicitation of an offer to buy any security in any state where such an offer or solicitation would be illegal. Any information expressed herein on this date is subject to change without notice. Any opinions or assertions contained in this information do not represent the opinions or beliefs of FactSet CallStreet, LLC. FactSet CallStreet, LLC, or one or more of its employees, including the writer of this report, may have a position in any of the securities discussed herein.

THE INFORMATION PROVIDED TO YOU HEREUNDER IS PROVIDED "AS IS," AND TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, FactSet CallStreet, LLC AND ITS LICENSORS, BUSINESS ASSOCIATES AND SUPPLIERS DISCLAIM ALL WARRANTIES WITH RESPECT TO THE SAME, EXPRESS, IMPLIED AND STATUTORY, INCLUDING WITHOUT LIMITATION ANY IMPLIED WARRANTIES OF MERCHANTABILITY, FITNESS FOR A PARTICULAR PURPOSE, ACCURACY, COMPLETENESS, AND NON-INFRINGEMENT. TO THE MAXIMUM EXTENT PERMITTED BY APPLICABLE LAW, NEITHER FACTSET CALLSTREET, LLC NOR ITS OFFICERS, MEMBERS, DIRECTORS, PARTNERS, AFFILIATES, BUSINESS ASSOCIATES, LICENSORS OR SUPPLIERS WILL BE LIABLE FOR ANY INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR PUNITIVE DAMAGES, INCLUDING WITHOUT LIMITATION DAMAGES FOR LOST PROFITS OR REVENUES, GOODWILL, WORK STOPPAGE, SECURITY BREACHES, VIRUSES, COMPUTER FAILURE OR MALFUNCTION, USE, DATA OR OTHER INTANGIBLE LOSSES OR COMMERCIAL DAMAGES, EVEN IF ANY OF SUCH PARTIES IS ADVISED OF THE POSSIBILITY OF SUCH LOSSES, ARISING UNDER OR IN CONNECTION WITH THE INFORMATION PROVIDED HEREIN OR ANY OTHER SUBJECT MATTER HEREOF.

The contents and appearance of this report are Copyrighted FactSet CallStreet, LLC 2022 CallStreet and FactSet CallStreet, LLC are trademarks and service marks of FactSet CallStreet, LLC. All other trademarks mentioned are trademarks of their respective companies. All rights reserved.