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HFC - Q4 2016 HollyFrontier Corp Earnings Call

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OVERVIEW:

Co. reported 4Q16 net income attributable to HFC shareholders of $53m or $0.30 per diluted share.

CORPORATE PARTICIPANTS

Julia Heidenreich *HollyFrontier Corporation - VP of IR*

George Damiris *HollyFrontier Corporation - President and CEO*

Doug Aron *HollyFrontier Corporation - EVP and CFO*

Rich Voliva *HollyFrontier Corporation - SVP of Strategy*

CONFERENCE CALL PARTICIPANTS

Roger Read *Wells Fargo Securities, LLC - Analyst*

Blake Fernandez *Scotia Howard Weil - Analyst*

Jeff Dietert *Simmons & Company International - Analyst*

Neil Mehta *Goldman Sachs - Analyst*

Brad Heffern *RBC Capital Markets - Analyst*

Paul Sankey *Wolfe Research - Analyst*

Edward Westlake *Credit Suisse - Analyst*

Doug Leggate *BofA Merrill Lynch - Analyst*

Paul Cheng *Barclays Capital - Analyst*

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

PRESENTATION

Operator

Welcome to HollyFrontier Corporation's fourth-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)

Please note that this conference is being recorded. It is now my pleasure to turn the floor over to Julia Heidenreich, Vice President, Investor Relations.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Thank you, Jack. Good morning, everyone, and welcome to HollyFrontier Corporation's fourth-quarter 2016 earnings call. I'm Julia Heidenreich, Vice President of Investor Relations. This morning, we issued a press release announcing results for the quarter ending December 31. If you would like a copy of the press release, you may find one on our website, hollyfrontier.com.

Before George and Doug proceed with their remarks, please note the Safe Harbor disclosure statement in today's press release. In summary, it says statements made regarding management expectations, judgements, 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. The call also may include discussion of non-GAAP measures. Please see the press release for reconciliations.

Also, please note that information presented on today's call speaks only as of today, February 22, 2017. Any time sensitive information provided may no longer be accurate at the time of any webcast replay or rereading of the transcript. And with that, I'll turn the call over to George Damiris.

George Damiris - *HollyFrontier Corporation - President and CEO*

Thanks, Julia. Good morning, everyone. Today we have fourth-quarter net income attributable to HFC shareholders of $53 million or $0.30 per diluted share. Included in the current quarter results were a noncash lower cost for market inventory adjustment that increased pretax earnings by $98 million and pre-acquisition costs related to a recent PCLI purchase that decreased pretax earnings by $13 million.

Excluding these items, adjusted net loss attributable to HFC stockholders was $10 million or $0.06 per diluted share. Fourth-quarter EBITDA, excluding the inventory valuation benefit and acquisition costs, was $101 million, 37% below the comparable quarter last year due to lower crude spread, narrower crude differentials and higher costs associated with the RFS mandate. Fourth-quarter crude BPD was 430,000 barrels per day versus our revised guidance of 440,000 to 450,000 barrels per day.

During the quarter, we experienced unplanned maintenance on our Navajo and Tulsa [cataytical] reforming units. During the Tulsa outage, which extended into the first quarter, we were able to accelerate maintenance originally planned for later this year and took the opportunity to upgrade catalysts, which will allow us to benefit from higher liquid yield and octane during the summer driving season.

For the first quarter 2017, we expect to run between 350,000 and 360,000 barrels per day of crude. Impacting weight in the quarter is a planned 40-day turnaround at Navajo. During this turnaround, we will also recycle streams in our operation, which will improve efficiency along with the increased crude capacity by approximately 5,000 barrels per day and improved flexibility to run a larger crude slate. We also have a 17-day planned outage in El Dorado on our vacuum tower.

Also, our Woods Cross plant is currently upgrading at reduced rates due to the Salt Lake City pipeline outage impacting crude deliveries. Our outlook for 2017 remains cautiously optimistic. We're encouraged by the new administration's energy plan and its pro-growth economic policies and our potential to increase domestic crude production and demand for refined products.

Combined with recent indications of compliance with the OPEC production cuts, these impacts should drive the reemergence of inland crude differentials and improved craft spread. We're also optimistic that the flaws and FLBs inherent with the RFS will be addressed. On February 1, we announced the closing of our acquisition of the Petro-Canada Lubricants business, welcoming over 725 talented team members to HollyFrontier. We're now the fourth largest base oil producer in North America and the only North American producer of high margins with three base oils.

The Petro-Canada Lubricants business brings HollyFrontier industry-leading product innovation and R&D capabilities, a global sales and distribution network, and a strong brand portfolio recognized globally. Integration is off to a good start. We remain confident in our $20 million synergy target. There's also significant opportunity to increase group III base oil productions to appease that optimization.

Group III base oil enjoyed an $80 per barrel margin uplift versus group II base oils. PCLI is a transformative acquisition that advances our long-term vision of strategy and adds diversity to our earnings stream by providing a differentiated high-margin business that generates more stable cash flow. Combined with our existing Tulsa specialty lubricants business, it creates scale, operational and financial synergies, and strong platform for growth.

Although the current refining environment is challenging, HollyFrontier is well-positioned with a strong balance sheet, excellent liquidity position, and the additional stable cash flow from our lubricants business. Lastly, I want to thank Doug Aron for his 16 years of service to HollyFrontier. He's been instrumental in shaping the Company we are today. More importantly, he's been a great friend and valued colleague. We wish him and his family continued success and happiness. He will be missed, but not forgotten.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

Thanks very much, George. For the fourth quarter 2016, cash flow provided by operations totaled $164 million. Turnaround spending in the fourth quarter was $21 million and HollyFrontier standalone capital expenditures totaled $81 million. This took our full-year capital and turnarounds down to just under $500 million at $497 million versus our $560 million guidance due to the deferral of some projects.

We expect to spend between $400 million and $450 million of standalone capital in 2017, including the turnarounds and carryovers stemming from 2016. Additionally, we expect to spend $30 million of capital for ATP and $30 million for PCLI. As of December 31, 2016, our total cash and marketable securities balance was $1.1 billion. During the quarter, we announced and paid a $0.33 regular dividend, putting our yield at 4.4% as of last night's close.

For the year, we returned approximately $367 million of cash to our shareholders through dividends and buybacks. In November, HSE issued an additional $750 million for our existing seven 5.857% senior unsecured notes due in 2026. A portion of the proceeds were used to repay the $350 million term loan and the remaining amount was used to help finance the PCLI acquisition.

Last week, HSE upsized its senior unsecured revolving credit facility from $1 billion to $1.35 billion and extended the maturity to 2022. As George mentioned, earlier this month, we closed on the acquisition of our Petro-Canada Lubes business for $862 million. The $862 million purchase price was funded with cash on hand.

As of February 15, we have $1 billion of standalone debt and no drawings under our credit facility. Our cash position after PCLI funding stands at approximately $208 million and puts our liquidity at a healthy $1.6 million and debt-to-capital at a very modest 18%.

I'd like to mention a few of usual items during the quarter. Fourth-quarter earnings were impacted by $13 million in M&A related charges, a portion of which was unrealized loss on the currency hedge related to PCLI. In conjunction with the closing, we have exited that hedge position resulting in a net gain that will be realized in the first quarter and an effective purchase price for PCLI of $845 million.

As a reminder, HollyFrontier owns 35% of Holly Energy Partners, that's 22.4 million common units plus the 2% general partner interest. HEP units continue to perform strongly with current market value of LP units at approximately $827 million as of last night's close. Fourth-quarter general partner distributions were $15.9 million, a 40% increase over the same time last year.

For the full-year 2016, we have received approximately $105 million in LP and GP distributions from PHEP. A reminder that you can find our monthly WTI-based 321 indicators for our Mid-Con Rockies and Southwest regions posted on HollyFrontier's investor page. These regional indicators do not reflect actual sales data and are meant to show monthly trends. Realized gross margins per barrel may differ from the indicators for a variety of reasons. You can find that data on our investor page at www.hollyfrontier.com.

Before moving to the Q&A portion of the call, I'd like to call out a few personnel changes we are making. First, I'm pleased to announce that Julia Heidenreich, currently Vice President of Investor Relations, and well-known to this group, has been promoted to VP, Commercial Analysis and Pricing. I'm sure you guys will agree with me that Julia has been an absolute all-star in the IR role and will be missed. But our loss is very much the commercial group's again.

I'm also proud to announce that Craig Biery has been promoted to Director of Investor Relations. Most of you have been working with Craig for a while now as he's been leading the IR effort for HEP for the last year. We're highly confident in Craig's ability to backfill for Julia.

Finally, I'd like to say thank you to this group of analysts and our shareholders. When I started 16 years ago, only Paul Cheng and Fred Roofer were recovering our $250 million micro cap refinery in Houston. Jeff Dieder, Paul Sankey and Chi Chow started covering us soon thereafter and I've enjoyed just about every minute of that ride.

Thanks to all of you guys for the support and the hard questions, but perhaps you can take it easy on us today, so I leave with fond memories. Jack, I believe now we are ready to open up the line for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Roger Read, Wells Fargo.

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

Thank you. Good morning. George, a lot of the policy stuff is still out there and I know it's been beaten up on a lot of these calls. But, can we get your updated thoughts on the RFS here and expectations now that the EPA head has been confirmed? And also maybe any updated thoughts on the border tax.

George Damiris - *HollyFrontier Corporation - President and CEO*

Sure. First, on the RFS, I don't think there's a whole lot new to report there. I think we think we're optimistic, as we've said previously. We view the confirmation of Scott Pruitt as being positive. I think he's not going to be as radical as some would think him, but I think he's looking to be much, much more receptive to discussions on the intentions and the application of RFS standard. So, again, we are cautiously optimistic that something will be done to fix the flaws in the RFS.

On the border adjustment tax, I think there's been more discussion in the investor community than there probably has been even in Congress on this one. We're definitely applaud the administration and Congress 's efforts on tax reform. The full taxpayer whatever could be done to reduce taxes so that, just like individuals, we can bring home more of what we rightfully earned and deploy it to improve and grow our business.

Having said that, the border adjustment tax, we have serious concerns about it. The potential to increase gasoline prices by $0.30 per gallon in a $50 rent environment cannot be viewed positively for the industry or for the American consumer. But, again, we think it's very early in the process here. I don't think the border adjustment tax will go through, but that is just one man's opinion and I'm not in the business of forecasting what Congress will or will not do.

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

Yes, pretty dangerous thin ice to step out on there for sure. I guess with the PCL acquisition now closed, you've had it for I think about three weeks. Anything that stands out now that you officially own it and you've been up to look at it that either confirms your views or seems more optimistic or potentially more of a challenge in some of the transition?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think it still very early. Like you said, we're three weeks into this. We're getting to know the business and the people there better. We don't see any thing that surprises us to the downside there. Most of what we're seeing only confirms and gives us more optimism on potential improvements and upsides on that business.

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

Okay, great. Thanks and welcome back to H-town, Doug.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

Thanks, Roger.

Operator

Blake Fernandez, Howard Weil.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Hello, guys. Congrats to everybody on the various movements. Basically a follow-up on that last question. It sounds like operationally things are moving in the direction you had expected. I think in the presentation you had outlined three different scenarios for the outlook and earnings accretion potential.

Without explicit visibility on the margin environment, obviously overall refining has been weak. Can you confirm where we sit on those three scenarios in the current environment? I presume we're toward more of scenario one, which would be a lower earnings accretion potential.

George Damiris - *HollyFrontier Corporation - President and CEO*

Blake, I'm not sure I'm following the three scenarios you are referencing.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Well, I think in the acquisition presentation, you had outlined three different scenarios where one would be a lower earnings accretion, I believe it was 3%, all the way up to scenario three, which was 22% accretion. I presume that had to do with various underlying EBITDA generation based on the margin environment. I'm basically trying to understand what the current lubes margin environment looks like.

George Damiris - *HollyFrontier Corporation - President and CEO*

I think it's safe to stay with the middle case of roughly $150 million of EBITDA with upside from there. But, again, very early to call. Stick with the middle case.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Okay. When do you think we can get a breakout of those financials separately?

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

I think we will be reporting something at the end of the first quarter, we will showing PCLI as a separate business segment.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Okay and then the follow-up I had, I know you covered border tax, but just to confirm, obviously, those facilities are located up north of the border. I presume a lot of those products are actually sold into the US, but is that the case?

George Damiris - *HollyFrontier Corporation - President and CEO*

That is correct. About 40% of the product comes into the US and border adjustment tax would definitely be a concern there.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Okay. That's all I had. Thank you.

George Damiris - *HollyFrontier Corporation - President and CEO*

Thanks, Blake.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

I would add to that, Blake, that I'm sure you've seen as we speculate on whether there will be a border adjustment tax and if there was one, of all of the borders that would be most likely to be friendly and seems like early indications it is that commodities to and from Canada would be exempted. If we're putting a 20%-some chance on a border adjusted taxes with consensus, I'm saying that likelihood then that Canada would not be exempted, it becomes considerably smaller from there.

Blake Fernandez - *Scotia Howard Weil - Analyst*

Agreed. Thank you.

Operator

Jeff Dietert, Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning. Doug, would love to wish you all the best. It's been a fun ride. I have thoroughly enjoyed it. All the best to Julia Craig and Rich as well. Could you talk a little bit about what you are seeing in the Permian, maybe scoop stack and even potentially early in the Uinta and what increased production in those regions, how that might impact your crude feedstock flexibility?

George Damiris - *HollyFrontier Corporation - President and CEO*

Sure. In the Permian, we are seeing the rig count in the production levels increasing. I don't think there's any secret there. A lot of that is in the counties that are right around our Artesia and Wilmington refineries. We are pleased to see that increased production.

That presents opportunities for both our refinery in Artesia, New Mexico as well as HEP that participate in the midstream business around those assets. Having said that, there's a lot of pipeline capacity to the Permian to the Gulf Coast, where it's going to take a significant continued increase of production to fill up those pipelines to lead to widening crude differentials between Midland and say Cushing or the Gulf Coast.

Jeff Dietert - *Simmons & Company International - Analyst*

Before you leave the Permian, any crude quality issues that you're seeing with the recent production adds?

George Damiris - *HollyFrontier Corporation - President and CEO*

Sure. Jeff, directionally, the incremental crudes from the shale production there are lighter, but one of the reasons why we are pleased with this project that we're going to be doing during the turnaround to emulate those recycle streams and allow us to increase our ability to run lighter crudes. There's no question there's going to be, need to be some solutions to placing these higher gravity crude into existing pipeline infrastructure, and again, this is one area where we hope that HEP will be actively participating. Anything else on the Permian, Jeff, or is that good?

Jeff Dietert - *Simmons & Company International - Analyst*

No, that is good.

George Damiris - *HollyFrontier Corporation - President and CEO*

Okay. Scoop and stack, we're not experts in that area. We see it secondarily to the movement of that crude to Cushing. From what we see and know, scoop and stack is another, much smaller, player in the Permian, but comparable to Permian, where, again, production is very active. And again, the incremental barrel tends to be lighter than your typical 42 gravity WTI.

On the Uinta Basin, we're seeing some signs of production there by smaller producers. Larger producers like New Field have other plays they are focused on. But you see smaller producers picking up the slack and it's very early in that pickup. It's one of the last basins that we anticipate production increasing, but for producers that don't have positions in the other plays like the Permian and scoop and stack, we're seeing interest in producing those barrels. It's a much lower risk play in [ENO]. The crude is there. It is just a matter of financing the wells and having a market like us to produce it in.

Jeff Dietert - *Simmons & Company International - Analyst*

Great. On the Tulsa naphtha splitter, I'm sorry if I missed it, but did you provide an update or could you provide and update on the progress there?

George Damiris - *HollyFrontier Corporation - President and CEO*

That project is on hold for now. We continue to work with engineering and cost estimate. We're still optimistic about that project. It's going to be a good one for potential octane and tier III solutions, but it's not something that we need for either. It's just an opportunity investment for us to further decrease our gasoline sulfur for TFC and make more octane. But again, we can lead tier III and produce our octane without that project.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks for your comments and good luck to everyone. Thanks.

Operator

Neil Mehta, Goldman Sachs.

Neil Mehta - *Goldman Sachs - Analyst*

Hello, guys. Rich, Julia, Craig, congratulations to you all. My first question is as it relates to the Rockies business and the path to improving profitability and I was wondering if you guys could talk about what you're going to do to try to drive down the operating costs at Cheyenne and then also improve margin realizations at Woods Cross as you look into 2017 and 2018.

George Damiris - *HollyFrontier Corporation - President and CEO*

Sure. I think a couple things on that, Neil. We have some initiatives that are based on or driven towards the OpEx, just the dollars perspective. We have some fixed costs that we need to drop out of the system, maintenance being the biggest one, but we also have a series of other smaller targeted cost-reduction efforts, water consumption being one I can highlight. But the biggest opportunity we have in the Rockies is getting throughput up.

That's been our biggest challenge in Cheyenne. That refinery is rated at 50,000 barrels per day. It's actually 52,000, but it's tough for us to run at that crude capacity. The downstream is not matched up to that rate. But there's no reason we shouldn't be able to run the facility in the high 40,000s: 47,000, 48,000.

We have reliability initiatives in place to go get that and that constraints in coke handling and sulfur handling that we're addressing as well. The models not only increase the throughput, but also increase the percentage of WCS in front of that facility, which fits to your gross margin question.

But when you look at gross margin, that is our biggest facility to influence it is on the fluid side of the equation. The product market is what the product market is. The big lever to increasing our WCS percentage in that fluid side, that's Cheyenne.

Neil Mehta - *Goldman Sachs - Analyst*

That's great, George. I'm sorry if I missed it, but can you call out your 1Q throughput guidance again and can you talk about any pipeline outages in the Salt Lake area and how that's impacted the Rockies? And then I have a quick follow-up.

George Damiris - *HollyFrontier Corporation - President and CEO*

Yes, we've guided 350,000 to 360,000 for the first quarter. Again, it's impacted by some turnaround, the biggest one being Navajo where we have a 45-day outage that looks like we need about every unit in the refinery down in various stages and then we have a 17-day outage and El Dorado, which will impact crude rates there appreciably.

Neil Mehta - *Goldman Sachs - Analyst*

Thanks, George. My follow-up is on the gasoline markets. How do think we're positioning going into the summer? Inventories are elevated, but we're going into the summer and do think those product builds are more of a function of weak gasoline demand as some of the statistics would imply or it's just the industry running at elevated utilization right now?

George Damiris - *HollyFrontier Corporation - President and CEO*

As far as builds, they're basically at the same level where they were last year. The good news is the build is less this year from last year, not significantly less, but less nonetheless. And on the build side, I think there's definitely some questions on demand. I don't think that demand has decreased as much as some of the reports would indicate.

And when I see that demand decreasing 4%, that sounds very high to me. Which suggests there might be some weather issues in the data or perhaps some issues with export data and how that calculates into a demand number. I still think that the majority of the build in refined products, especially gasoline, is more supply driven.

And I think we have more maintenance planned this year than perhaps last year and hopefully with this turnaround coming up, that will decrease inventory levels and some of the inventory level will go up in advance of those turnarounds so that and as we did it at Navajo, they're [dance] about turnaround there, we built inventory so that we could supply our customers during downtime.

Neil Mehta - *Goldman Sachs - Analyst*

Appreciate it, guys.

Operator

Brad Heffern, RBC Capital Markets.

Brad Heffern - *RBC Capital Markets - Analyst*

Hello, everyone. George, just a follow-on to the last question. You have the downtime in the first quarter, but it seems like the guidance is particularly weak. I was wondering if it includes any sort of economic run cuts at any of the facilities.

George Damiris - *HollyFrontier Corporation - President and CEO*

No, no. There is no economic run cuts. As you know, we have a pretty good product market location product but are net short product and with the incremental barrel coming from somewhere else. We typically run our plants full-out. The last time we got an economic run cut was about a year ago now, it was about 5,000 a day and it lasted for about a week. So, no harm in the increase.

But again, the reason the numbers might be low is we have, again, the turnarounds at Navajo. It's 45 days, significantly half of the quarter, Navajo is going to be at significantly reduced rates. Again, El Dorado is going to down for 17 days. When the vacuum tower, the fluid tower goes down with it. And then we have the 12 to week former that we mentioned. That downtime occurred in the fourth quarter and still into the first quarter.

And then one of the questions the Neil asked that I forgot to address was Woods Cross. There are issues with the Salt Lake City pipeline. That's the major supply pipeline into all the refineries in Salt Lake. So, we are running at reduced rates there, roughly in the ballpark of 30,000 to 31,000 barrels a day versus our high-30,000s that we've run since the turnaround. This was the Woods Cross expansion turnaround.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay thanks for that color. And then another question on PCLI. Can you talk about what the performance was in the fourth quarter or if the final 2016 performance came in close to that $150 million annualized number? Additionally, can you talk about what the margin trends have looked like, how things have looked in the first quarter versus maybe where we were in the fourth quarter?

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

Yes, Brad, on the first question, what I would tell you is that because this non-GAAP, non-audited results that we see in Suncor did not break the valve and we cannot give an exact number, but we will tell you that, yes, we are very comfortable with the previous guidance and the $150 million number you mentioned, again, on a non-GAAP, non-audited basis looks very close to exactly what we were expecting and what the actual results were. As to the margins, I'll let Rich or George, maybe Tom, comment.

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Hello, Brad. It's Rich. I think on the base oil side, the year started off a little bit soft, not unexpected seasonally and downstream of that, finished product margins remain strong. So we, again, to Doug's point, feel very confident in our numbers and our guidance around PCLI.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay. Thanks, everyone.

Operator

Paul Sankey, Wolfe Research.

Paul Sankey - *Wolfe Research - Analyst*

Good morning, everyone. To all, congratulations on your respective moves. Particularly, Doug, it's been a pleasure. I was already a bit nostalgic looking back at HollyFrontier stock trading at $6 in 2004 before you started the tearful tribute to those of us who have been covering the stock a long time, so thanks for that.

Without further ado, George, with these changes we are in a little bit, I think, I feel a little bit of a vacuum on your strategy. I know that you've been announcing this on various calls, but I just wondered are you planning an analyst meeting or a formal reset of the outlook, again, given the changes that are being made in personnel? Thanks.

George Damiris - *HollyFrontier Corporation - President and CEO*

Yes, I think we're planning an analyst day meeting later this year, probably in December.

Paul Sankey - *Wolfe Research - Analyst*

Right. So we can look forward to that as being a, I don't know about strategic reset, but formalization of where we are in terms of strategy. At the moment, we're bouncing along with this doubling concept, which I think I'm still a bit unclear about. Could you give us your latest thoughts on that?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think 2017 is going to be very focused on integrating and making the improvements we anticipate and capturing the synergies with PCLI. We are still going to be looking for other opportunities, but our primary focus, again, is going to be on PCLI. That's obviously a huge acquisition for us.

We think there's tremendous potential to integrate that with Tulsa and to use that platform for growth. There are other opportunities that we're looking at, both in refining and for HEP, especially in the Permian. But, by far and away, our biggest priority is PCLI this year.

Paul Sankey - *Wolfe Research - Analyst*

Understood. For what it's worth, that's very much what Douglas was saying at our conference in January for you guys in 2017. That has cleared that up a little bit for me. Just a follow-up, the Rockies results, you mentioned there been issues with running the refineries at a higher utilization. But, do you think there's also potentially a secular shift here in terms of Rockies margins, which have historically always been relatively good? I'm just concerned that the market may have structurally altered. Thanks.

George Damiris - *HollyFrontier Corporation - President and CEO*

The biggest structural change in the Rockies is on the crude side again. It's a $50 crude, there's obviously more production. Then there's the $100 crude. You see that across the entire domestic sector, but you especially feel it in the Rockies. We've seen significant contractions or narrowing of crude differentials there and that's the biggest change in the second half of last year is that the crude that we've typically enjoyed at Cheyenne, especially at Woods Cross, has narrowed significantly in the last few months.

Paul Sankey - *Wolfe Research - Analyst*

I guess the question is do you expect that to continue?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think that it will continue until, again, production increases. And that's going to be driven by crude price.

Paul Sankey - *Wolfe Research - Analyst*

Thanks, and again, Doug, good luck.

Operator

Edward Westlake, Credit Suisse.

Edward Westlake - *Credit Suisse - Analyst*

Congratulations to everyone again and thanks, Doug, for all your help over the years. Just a quick one on the Woods Cross pipe. Any issuance of any sort of timeline in terms of when they get that fixed?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think we're on a day-to-day basis here, working to get the permits and permissions we need to get in there and do the work. I think the work is well-defined what needs to get done. But it's really just the upfront work that needs to get done to clear the way for the fix.

Edward Westlake - *Credit Suisse - Analyst*

And then on the PC -- sorry.

George Damiris - *HollyFrontier Corporation - President and CEO*

Go ahead, Ed.

Edward Westlake - *Credit Suisse - Analyst*

I was going to say, on PCLI, I mean, one of the, I guess, the aspirations of the synergies was to get the black wax crude up and to run that through and see if you can make group III loops and get the uplift. What sort of time would it take post-close to run those tests?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think the fee optimization is not exclusively the wax crude gas oil. I think there's also feedstock from Tulsa, since we're a third-party feedstock, it would all be conducive to making more group III versus group II. I think we should give us a little time and check about towards the end of the year to see some of that coming through.

Edward Westlake - *Credit Suisse - Analyst*

Great. Coming back to RINs, I mean, obviously, shifting the board of obligation is something that the independent refiners have argued for and there've been a lot of other people on the other side saying we should not maybe a little bit of color as you've gone through the comment period as to, it may be still early as to which way you see the odds on that.

George Damiris - *HollyFrontier Corporation - President and CEO*

Again, putting odds on things like this is very difficult to do. I would put the odds are greater than 50% and less than 100%, so I think in the midpoint, 75%. I think there's no question there's a lot of people on the other side of this, but the people that are on the other side of this are frankly the people that are realizing unintended windfall profits from this.

So, but we still believe we have right on our side, whatever the intents of the RFX to generate winners and losers to this magnitude. Again, to generate profit centers that were never intended to exist.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

And I would just add to that, Ed, that as George mentioned in the open, while the new chair of the EPA, Mr. Pruitt, is not likely to be a radical, our experience having worked with him as the Attorney General in Oklahoma with our ownership of the refinery there is that he is of sound mind and a critical thinker and one that is certainly at least willing to understand both sides and our view, as George said, is that there is a better than 50/50 chance that we get some movement there. Don't know until it's done, but again, our view is a better than average chance.

George Damiris - *HollyFrontier Corporation - President and CEO*

I guess one last thought on this one, Ed. The flaws in the RFS could never be better illustrated than what we've seen since the election. We're infiltrating over dollar and right now, they're trading for less than $0.50. There is no fundamental change in supply/demand balance for RINs. So again, it just highlights the speculation and how subject to manipulation the RINs market is and how the misalignment between the points of obligation and the point of bonding is causing this market to be highly distorted and it needs to be fixed.

Edward Westlake - *Credit Suisse - Analyst*

Thanks very much.

Operator

Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Thanks. Good morning, everybody. Again, congratulations to everybody. Doug, I guess we won't see you next week at our refinery conference, but good luck. I guess, George, if I kick off the questions going back to M&A for a second.

Obviously, the lubricants acquisition has a fairly meaningful impact on your outlook. What does the M&A market look like on the lubes side as it relates to your expansion plans? Because I think we're all guilty of thinking of refining and I'm wondering if we're skewing our bias a little bit the wrong way.

George Damiris - *HollyFrontier Corporation - President and CEO*

That's one of the reasons why we like PCLI deal. That, again, in combination with Tulsa, it gives us scale to basically have a full third leg to our growth story here. We think there's opportunities in the M&A arena for lubes just like there are, again, like you said, on the refining MLP side.

We're, again, very early in the stages of tapping into that deal flow, but we see deals of various sizes in the lubricant space that would be nice bolt-ons to PCLI. We don't have any specifics to share at this time, but we're encouraged by what we're seeing this early in the game and getting into that deal flow.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Related question, George, if I may. You said in your prepared remarks, outside of the synergies that you've declared on that acquisition, there's opportunities to expansion, volume expansion. Are you any further forward in those thoughts. Do you have any preliminary views as to what that could look like and what the capital allocation could be? Is there any color you can offer or is it still too early?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think, Doug, we'd prefer to think of it as changing the product plate rather than volume expansion. The facility makes 15,000 or 16,000 barrels per day of base oil. And right now, it's about 20% group III and 80% group II, so we're actually II plus type of material. Again, very early stages of what we could do with the feedstock optimization strategy.

But, we think there's potential to increase group III production by a few thousand barrels per day, and again, every barrel that is converted from group II to group III has an $80 per barrel uplift. We think we can get this done with no to minimal investment.

We might need to make some pre-treating type investments, but we're talking something in the order of $5 million to $10 million. But, again, very early stages of quantifying both the potential and any potential costs associated with doing that.

Doug Leggate - *BofA Merrill Lynch - Analyst*

(Inaudible) Maybe if I could squeeze one last one in. I guess it might be a Doug Aron question, actually. But, all the focus is on RINs and border taxes and so on. But, we don't hear too much talk on the refining side about corporate taxes. Obviously, that's a big part of the Brady prop proposal is to drop the corporate tax rate.

I'm curious, what would that mean for Holly? Would we see a real reduction on cash taxes? And maybe if I could go into that, what would that, what is your latest thinking on priority of use of free cash assuming that returns later in the year? And I will leave it there. Thanks.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

Sure. Thanks. On the tax side, certainly prior to our PCLI acquisition, HollyFrontier is the definition of a full US taxpayer. We have been so and, certainly through the early part of this decade, paid a tremendous amount of US tax. If you get a reduction to 25% or 30% or 20% all of that would be incrementally very positive for us.

On the PCLI side, we do have a few structures that does help us with taxes there, but for the most part, again, a huge gain to us if we do get a change and that would be great. But, again, much the same with our comments on border adjustment. I think our tax department view is that, even if you get the consensus of something that gets taxed, at the very, very earliest, we'd be talking about back half of 2018 and perhaps later before you see something that's implemented. But, we'll keep our fingers crossed, certainly, on that one.

In terms of use of the free cash flow, we would love to have that problem and have it start as soon as the second quarter, but really no change there. I mean, we've deferred some discretionary opportunity growth CapEx projects that we think are very high return and I think that would be the first and those tend to be 1.5- to 2-year paybacks.

Hopeful, look at, I think share repurchase would be the next leg we'd look at because that's really been a preferred method versus the special dividends or such that we looked at earlier just after our merger. I'm certain Rich looks forward to that problem and hope it begins the day that I leave.

Doug Leggate - *BofA Merrill Lynch - Analyst*

I appreciate all the answers and congrats and good luck again, Doug. Thanks.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Hello, guys. Good morning. Doug, it has been a long time. Best wishes for you and also thank you for all the years. 1999 seems like ages ago. It was really the dark age back then. And Rich, Julia, and Greg, congratulations and best wishes in your new positions. I probably have two questions, if I may.

George, I was curious that it looked like in the MLP sector, that the prevailing wages that everyone believes, the GP and the LP should be collapsed and that we about the LP to have a better funding or the cost of capital. You guys have been one of the grand daddies and the GP is already well in the 50% split. Is there something that you guys believe you should do and allow you to have a better vehicle to grow or that you do not believe it applies to you?

George Damiris - *HollyFrontier Corporation - President and CEO*

No, that's definitely something that we're looking at, Paul. We do have our hands a little bit busy like we've talked about right this minute with PCLI and closing the year's financial statements. But, we will definitely be looking at this. There's a lot of tax implications here that we need to really get into the details. As you know, the devil's in the details on that type of thing. But we think it is something that could be potentially be good for both HEP and HFC as the GP.

Paul Cheng - *Barclays Capital - Analyst*

Based on what you just said, because you are going to focus the 2017 on the integration, so should we assume anything on the HEP structure probably is not a this-year event if it happens?

George Damiris - *HollyFrontier Corporation - President and CEO*

I would not say that. I think if it's something that's going to be good, I think that's something we can figure out this year. If it is good for both sides, then I think it'll be something that potentially could be done this year. No guarantees, but again, I would think sooner rather than later on that.

Paul Cheng - *Barclays Capital - Analyst*

Second question.

George Damiris - *HollyFrontier Corporation - President and CEO*

That is your third question, Paul. Just saying.

Paul Cheng - *Barclays Capital - Analyst*

I thought that idea was just one question.

George Damiris - *HollyFrontier Corporation - President and CEO*

Well I just saw your quarter side set here, so I wanted to let you know.

Paul Cheng - *Barclays Capital - Analyst*

The second question is then, typically that an independently finer doesn't want to get into a joint venture of refining operations with another person? But if the answer is right, is that something that you guys would consider like, for example, not that you would do for that specific outfit when you are looking at JV. I mean, 50% that would be cleaned up by raw slate, but if there's an opportunity, will you be willing to get into or do think that it will work for your strategy on your operation?

George Damiris - *HollyFrontier Corporation - President and CEO*

Yes. I think the conversion to JV is it's not limited to us or to refining in general. As you know, the issue with JV is that if, even if both parties consensus is perfectly aligned at the beginning, over time, they can tend to drift and become misaligned. I think the Motiva venture is a good case study in that one. So again, initial alignment is difficult and then maintaining alignment over time is again difficult.

But having said all that, Paul, never say never. If there are enough incentives to enter a JV, especially on a refining JV, where perhaps we'd bring something to the table from a marketing or supply perspective or operational perspective, gives us trading opportunities, sure, we would look at it. But going in, we would be with a very cautious eye.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Operator

Chi Chow, Tudor, Pickering, Holt.

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

Thanks. Doug, man, you make me feel really old with your comments going way back that far. I guess not as old as Paul goes, so I appreciate that. It's been great working with you over all these years that you mentioned, so best of luck. Do you guys have estimate on the lost opportunity cost in both the fourth quarter and full year 2016 due to unplanned maintenance?

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

I think for the full year, Paul, it was about $90 million, $95 million. And for the fourth quarter, it was about $28 million.

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

Okay. It just seems like unplanned downtime continues to be an issue. What does it take to improve the reliability on time of your plants going forward here?

George Damiris - *HollyFrontier Corporation - President and CEO*

Sure. At the highest level, we agree with your statement. We are not pleased with where we are here. We are not meeting the objectives that we set up in our business improvement plan. But having said that, at the risk of sounding like I'm making excuses, extenuating circumstances on some of our downtime.

For example, the Tulsa reformer that we highlighted in the prepared remarks, the issue with that downtime is primarily associated with the original conversion of that unit to a CCR that was done prior to HollyFrontier even taking ownership in that facility and it's taken basically 10 years for that design flaw to show up and it's basically some support rings and caps internal for the reactor that's failed and basically, the eternals to the reactor altered and move that point.

But, having said that, having said that, we are fully focused on operational improvements, we've made significant investments in people and in our efforts to improve reliability, especially in utility systems. We have got a team of 10 to 15 people here in Dallas at the corporate level lending assistance to the plants to improve their reliability across the board.

One of the best examples I think I can highlight is our BMI program, where we've identified various pieces of pipe that had it not been for this program could have failed and could've led not only to downtime, but significant safety events in that facility.

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

Okay, great. Thanks, George. Appreciate that. On PCLI, I just want to try to understand the cost structure a bit better there. What can you say about percentage of fixed versus variable costs at the facility?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think we're not going to get into a whole lot of detail here. We'll start sharing more of that information as we report our financials. But at a high level, this is a very fixed cost driven business, as refining tends to be in general. Especially so in the differentiated high-margin business in that we have a lot of pretty big sales in R&D staff associated with PCLI. Beyond the plant level, there is also fixed cost associated with those capabilities.

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

Okay. I guess on product pricing, would you say that pricing is more elastic or inelastic to crude prices at PCLI?

George Damiris - *HollyFrontier Corporation - President and CEO*

I think it's less sensitive to changes in crude price than refined products definitely are. It sensitive, but much less so, and I would say that also, it tends to be more lagged than we find products typically are.

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

Okay, great. Maybe just one more question. Can you give some idea of what details you're going to provide when you report PCLI earnings? Are you going to give us volumes and margins by product category or any comments on that end?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Hello, Chi. It's Rich. So, we've been on the ground for about three weeks now and credit to our accounting department, they've also been trying to wrap up a 10-K, so it's really premature to go there. We will have some detail and we will report this as a separate segment for the first quarter and I expect this will also evolve with time.

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

Okay. All right. Thanks a lot. I appreciate it.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Just a quick follow-up. The closing costs related to PCLI, where did you guys put it. Is it under corporate or is it under refining? And also do have an number for the RIN costs in the fourth quarter?

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

PCLI costs are in corporate and RINs for the fourth quarter, Julia?

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

$75 million.

Doug Aron - *HollyFrontier Corporation - EVP and CFO*

$75 million and the full-year was $240 million.

Paul Cheng - *Barclays Capital - Analyst*

Also that, one more, George for tier III, can you tell us how many of your refineries are currently in compliance and what is the remaining schedule for the rest of your portfolio?

George Damiris - *HollyFrontier Corporation - President and CEO*

All our refineries can meet the tier III requirements. We had our last plant was Navajo and we have our prime G units just completed there. And it is ready to start up if we need it. Those other two plants are the smaller plants, Woods Cross and Cheyenne, and both of those have small refinery exemptions to push out the compliance until 2020.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Operator

There are no further questions at this time. I would now like to turn the call back over to Julia Heidenreich.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Thanks, everyone. We appreciate you taking the time this morning to join us. If you have any follow-up questions, as always, Craig and I will be available all day. Thank you very much.

Operator

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