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HFC - HollyFrontier Corp to Acquire Suncor Energy Inc Petro-Canada Lubricants Business - M&A Call

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OVERVIEW:

On 10/31/16, HFC announced the acquisition of Suncor Energy's Petro-Canada Lubricants business for purchase price of CAD1.125b or approx. $845m, including working capital of approx. $260m.

CORPORATE PARTICIPANTS

Julia Heidenreich *HollyFrontier Corporation - VP of IR*

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Paul Cheng *Barclays Capital - Analyst*

Brad Heffern *RBC Capital Markets - Analyst*

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PRESENTATION

Operator

Good morning. My name is Jacqueline and I will be your conference operator today. Welcome to the HollyFrontier Corporation management update call. I would like to now turn the call over to Julia Heidenreich.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Good morning, everyone. Thank you for joining us today to discuss the transaction we announced this morning to acquire Suncor's Petro-Canada Lubricants, Inc. I'm Julia Heidenreich, Vice President of Investor Relations. A slide deck for the conference call can be found on our website, HollyFrontier.com, in the investor relations events and presentations section. Joining us today is George Damiris, President and CEO; Doug Aron, CFO; and several other members of Senior Management.

Before Doug, George, and others proceed with their remarks, please note the Safe Harbor disclosure statement in today's press release. We will be making forward-looking statements on today's call. There are many factors that could cause results to differ from expectations, included those noted in our SEC filings. Today's statements are not guarantees of future outcomes.

Please also note that any comments made on today's call speak only as of today, October 31, 2016, and may no longer be accurate at the time of any webcast replay or transcript rereading. With that, I will turn the call over to George.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thank you, Julia. Good morning, everyone, and thank you for joining us. Before we begin, I would like to acknowledge the efforts of our entire deal team that's been working hard on due diligence, deal structure, and negotiations.

I would like to give a special callout to four members of our deal team who spent the better part of the last two weeks on the detailed negotiations: Tom Creery, our Senior Vice President of Commercial; John Harrison, our Business Development Manager; Denise McWatters, our General Counsel; and Rick Voliva, our Senior VP of Strategy. Those four are in the room with us today and will handle all the really tough questions we get today. Thanks to all of you for making this deal happen.

As Julia mentioned, the presentation can be found on our website. We aren't going to run through every page of the slide deck in detail, but we'll cover the highlights and leave plenty of time for Q&A.

Starting on slide 3, this morning HollyFrontier announced the acquisition of Suncor Energy's Petro-Canada Lubricants business for a purchase price of CAD1.125 billion, or approximately $845 million, including working capital of approximately $260 million. This represents a very attractive multiple of 4 times trailing 12-month EBITDA net of working capital. We expect the acquisition to generate between $100 million and $200 million in annual EBITDA and to be immediately accretive to earnings per share and cash flows.

The transaction is subject to regulatory approval and customary closing conditions. We expect it to close in the first quarter of 2017.

On slide 4, Petro-Canada Lubricants is a fully integrated business with a talented and experienced workforce. The processing plant is located in Mississauga, Ontario, and has 15,600 barrels per day of lubricant production capacity. It produces very [high-purity base] oils and is the only North American producer of high-margin, Group III base oils.

PCLI has a differentiated high-margin finished lubricants product portfolio, with strong brand presence worldwide. Along with this transaction, HollyFrontier will have perpetual and exclusive license for use of the Petro-Canada trademark lubricants. Petro-Canada Lubricants also has industry-leading product innovation and R&D capabilities, as well as a global sales and distribution organization.

Turning to slide 5, we are truly excited about this transformative acquisition. We are buying a great high-margin business that generates stable cash flows at a good price. PCLI has diversity of scale, especially lubricant scale, that HollyFrontier that we are confident we can improve and grow.

With this acquisition, HollyFrontier will become the fourth-largest North American lubricant producer, with 28,000 barrels per day of production capacity. Combining PCLI with our existing Tulsa Lubricants business creates a platform for growth. Importantly, Petro-Canada Lubricants gives us exposure to the strong growth potential for Group II+ and Group III base oils, driven by increasing industry standards.

We believe that the addition of PCLI to our existing lubricants production is essentially an underappreciated part of our Business. Going forward, lubricants will be a key component [locked out] our high-quality refining administering businesses that together will drive continued value creation for our shareholders.

Turning to slide 7, this is a unique opportunity to acquire state-of-the-art lubricant manufacturing facilities, and research and development centers. Petro-Canada Lubricants is integrated across the value chain from base oils to finished products and end customers. The plant has a flexible configuration, with both a high-pressure hydrotreating and catalytic dewaxing unit, and can process a variety of [continued streaming to produce 99.9%-plus pure base oils, some of the purest in the world.

Some of you may recall the petrol plant we had for a Woods Cross phase 2 expansion to convert [blast less] crude into Group III lubricants. We feel the Petro-Canada acquisition is a far more attractive alternative. The addition to greater feedstock flexibility, PCLI brings industry-leading product innovation, an extensive brand portfolio, and a global sales organization to HollyFrontier.

Global market demand is shifting towards high-performance lubricants, driven by new engine technologies and improved efficiency requirements. PCLI is a leading producer of the premium products required to meet these rising standards.

As you can see on slide 8, Petro-Canada lubricants produces a broad portfolio of finished lubricants, specialty products, and white oils derived from the high-quality Group II and Group III base oils. PCLI has a very high-margin finished lubricants portfolio. Finished lubricants accounted for a third of sales volumes and more than half of gross margin in 2015 due to their $100 to $200 per barrel crack spread.

Petro-Canada Lubricants' suite of products includes a complete line of passenger car motor oils and heavy-duty engine oils for commercial [transportation]. In addition to transportation fluids, PCLI also produces specialty lubricants, fluids, and greases used in manufacturing.

Petro-Canada's specialty products portfolio also enjoys margins in excess of $100 per barrel. These products include drilling fluids used both onshore and offshore, and waxes for water repellency.

Lastly, Petro-Canada Lubricants is the world's largest producer of white oils used in cosmetics and personal care products, as well as in pharmaceuticals, food, and agriculture. Products include capsule lubricant, and protective coatings for fruits and vegetables.

As many of you know, HollyFrontier currently produces 12,000 barrels per day of such lubricant products at our Tulsa refinery. Since Holly acquired the Tulsa refinery in 2009, we have continued to invest in our lubricants business to increase higher-margin product yields and reach new markets.

Our Tulsa lubricants business generates roughly $100 million in EBITDA annually. Tulsa produces a unique portfolio of products which consist of paraffinic oils, [aromatic] oils and waxes used in a wide range of specialty applications from rubber to horticultural oils.

Turning to slide 9, specialty lubricant margins are significantly higher than fuel margins, which is why lubricant companies tend to trade at higher multiples than refining companies. As you can see, our Tulsa lubricant margins have averaged $75 per barrel since 2011, well above our realized gasoline and diesel margins for the same periods. Group III base oils benchmark margins have averaged $140 per barrel since 2011. As mentioned earlier, several of Petro-Canada Lubricants' finished and specialty lubricant product margins are well above Group III base oil levels.

We believe PCLI complements our existing lubricants business. HollyFrontier is one of the leading suppliers of industrial oils in North America. Our experienced sales and marketing team has done a great job growing and entering new markets in South and Central America, Europe, and Asia. PCLI is a leading supplier to the automotive markets, and brings with it a global sales organization with locations in Canada, the US, Europe, and China.

We have identified several exciting opportunities for further improvement with the integration of Petro-Canada Lubricants. With that, I will turn the call over to Doug Aron.

Doug Aron - *HollyFrontier Corporation - CFO*

Great, thanks, George, and thanks to all of you for joining us this morning. As we turn to slide 10, you can see we conservatively anticipate $20 million in potential synergies, primarily driven by opportunities to improve our existing lubricants business by upgrading products and improving distribution. Beyond our synergy target, we see significant potential to increase higher-value product yield at PCLI through feedstock optimization.

On slides 11 and 12 we provide historical financial data for PCLI. As mentioned earlier, we anticipate the acquisition to add between $100 million and $200 million in annual EBITDA, and lead to between a 3% and 21% EPS accretion for HollyFrontier in 2017, using consensus estimates and a very conservative financing scenario.

Importantly, this value-enhancing transaction is possible in part because of our strong balance sheet and liquidity position, as shown on slide 13. We expect to fund the $845 million purchase price with a combination of cash on hand, as well as a possible new senior note issuance.

To illustrate our balance sheet capacity, adding $500 million of additional debt would increase HFC's stand-alone debt to cap modestly from 11% to 19%. We intend to maintain our investment-grade rating, as we think it provides us with an important competitive advantage. After extensive visits with both Moody's and S&P, we are confident we will maintain our current ratings with the acquisition and the anticipated financing scenarios.

Looking ahead, we expect to continue to generate strong cash flows and maintain our disciplined approach to allocating capital to maximize return for our shareholders.

Finally, turning to slide 14, you can see that given the higher, more stable lubricants margins, we anticipate lubricant EBITDA to account for more than 20% of normalized refining EBITDA compared to the 10% of EBITDA for a stand-alone HollyFrontier. HollyFrontier's transformation away from a pure-play refiner to a more diversified Company is one of the key benefits of this transaction. Based on the premium margins and lower volatilities of the lubricant business, we expect higher multiples for the consolidated Company, which will benefit our shareholders.

Let me end by saying that we're excited by what this transformational acquisition means for HollyFrontier, and look forward to the opportunities that exist upon the combination of Petro-Canada and the Tulsa lubricants business. Thanks again for participating this morning. And, Jacqueline, I now believe we are ready to open the floor for questions.

QUESTIONS AND ANSWERS

Operator

(Operator instructions)

Jeff Dietert.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning.

George Damiris - *HollyFrontier Corporation - President & CEO*

Good morning, Jeff.

Jeff Dietert - *Simmons & Company International - Analyst*

I appreciate the yield data on slide 8. Could you talk about the feedstock that's utilized by the facility?

George Damiris - *HollyFrontier Corporation - President & CEO*

Well feedstocks generically are a combination of gas oil and hydrocracker bottoms. And they are sourced from Canada and Europe primarily.

Jeff Dietert - *Simmons & Company International - Analyst*

And on your EBITDA slide, slide 11, I appreciate the historical information here. Could you talk a little bit about what were the major drivers of the strength in EBITDA in the 2011 and 2012 period? And then perhaps the major drivers on 2013 and 2014, just to give us some historical perspective on the lubes market.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think, Jeff, just like any business, one of the key drivers, although it's less of an issue here, is ultimately the supply and demand. And as you probably note, you follow the refining sector and the lubricant aspect of it as well, the large increment of Group II capacity came on the market right prior to 2013, 2014 time period. I think that explains the dip from the 2011 and 2012 petro levels. Prior to that, the supply-demand balance was in much better shape and that's why you see the higher levels in 2011 and 2012.

Jeff Dietert - *Simmons & Company International - Analyst*

All right. And you mentioned favorable industry fundamentals, is that primarily due with the changing fuel specifications? Or perhaps talk a little bit more about the industry fundamentals for lubes.

George Damiris - *HollyFrontier Corporation - President & CEO*

That's exactly right, Jeff. The DEP A standards, the push by the auto manufacturers for higher performance lubricant products to help achieve those DEP A standards that the major industry fundamentals pushing the demand for Group II+ and Group III products.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks for your comments.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thanks, Jeff.

Operator

Roger Read.

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

Hey thanks, good morning and congrats on the transaction. A couple of things, could we talk through the synergy side of it? Is $20 million as good as you think or just as good as you think by 2018? And what are some of the things synergy-wise that this does for you in Tulsa, since you mentioned that?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, I think we will be conservative with the $20 million, Roger. So I would set the [old work]. A lot of it is product pull-through. We think we can pull through some of our Tulsa products into this business and blend it into the formulations that are used in this business to make their finished products. I think we can also leverage the sales and R&D organizations that are inherent in the Petro-Canada Lube business to find new applications, markets and customers for the molecules that we produce in Tulsa.

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

Okay, thanks. And then a little bit of a step-out with this transaction, not completely since you are in the business, but I think a lot of us expected you to make a move within the pure refining space itself. So can you please, George, give us an idea of what made this attractive relative to a refining acquisition? And does it at all preclude you from doing something in the refining side, say in the next year or two, given what this is going to mean for the balance sheet, capital allocation, et cetera.

George Damiris - *HollyFrontier Corporation - President & CEO*

I'll take it in reverse order, I guess. I don't think it precludes us from doing a more traditional refinery acquisition, at least from a balance sheet perspective. My concerns there are more on the human resource side of the equation. We want to obviously integrate this business into HollyFrontier and do a good job there, but again, I would not preclude us from a traditional refining acquisition.

What we like with this acquisition, first and foremost, is that it's a great business. It's a differentiated business, it has, as we said, more stable cash flows, it's high margin. So I think it diversifies us away from the more traditional fuel frac spread that gives us exposure to these lubricant frac spreads that, as we said, tend to be in the triple-digits on a per-barrel basis and less volatile. We think it gives us a really strong third leg to our investment thesis and growth platform.

So in addition to refining, investors get our midstream business and also get exposure to lubricants now. As we also said, there's tremendous potential synergies between our existing businesses, not only our Tulsa lubricant business that we mentioned, $20 million per year, but we think there's also a tremendous opportunity to optimize the feedstock supply to this business, take products from Tulsa and withdraw to feed this facility that will allow us to make more of the higher-margin products.

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

That's great. Then just an accounting question, if I could. Tax rate assumptions on this, just curious, because you go from being solely a US Company to having some international exposure. Wondered if there's any net impact to think about there?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Hey Roger, it's Rich Voliva here. We've assumed that we'll be taking this all in on US tax rates. Obviously that's a very conservative assumption. Thinking corporate tax rate's 26%, I want to say. We'll be working, as George alluded to, the fee, we'll be working to optimize the tax situation as well. I think in the slide deck here we have shown the basic 35% US corporate tax rate.

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

Right, yes. That's what I was trying to figure out there. All right, thanks, Rich.

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Sure.

Operator

Paul Cheng.

Paul Cheng - *Barclays Capital - Analyst*

Hey, guys, good morning. George, just curious will you be able to share with us on the EBITDA on the second quarter and third quarter 2016?

George Damiris - *HollyFrontier Corporation - President & CEO*

I don't believe we have the third-quarter data available to us. But as noted in the slide deck, the first half of this year was $149 million.

Paul Cheng - *Barclays Capital - Analyst*

(Multiple speakers) With the oil price drop substantially in the first quarter, that puppy will not be able to use his as normalized run rate so I'm trying to understand in the second and third quarter when prices were relatively steady, what is the run rate and then maybe more normalized.

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Paul, it's Rich here. I think if you want a ballpark number like that, $150 million-ish is probably good. To your point, the back half of last year was weaker than the first half of this year. But net-net, I think that probably a relatively good run rate. That's why we think that $100 million to $200 million range is reasonable.

Paul Cheng - *Barclays Capital - Analyst*

Okay. And when we are talking about the synergy, George, can you elaborate a little bit more than how that you would be able to have one Tulsa? Because it seems like that you are not going to really change the way how the Petro-Canada Lubricants businesses being run is that first a correct statement or assumption? And if it is the case, then the bulk of the benefits looks like it's going to pull up the Tulsa. Can you elaborate a little bit more in terms of what's the actual or major area that you can benefit?

George Damiris - *HollyFrontier Corporation - President & CEO*

I'm not sure how much more specific I can get than the answer to the previous question, Paul. But again, I think there's opportunities to pull through some of the Tulsa molecules through the Petro-Canada Lubricants business. And then also to leverage the R&D and sales capabilities of PCLI to sell the Tulsa molecules.

And again, that's just from the synergy perspective. We are not counting any benefits from feedstock optimization in that $20 million of synergies, Paul. So in addition to the $20 million of synergy, we believe we can take, again, feedstock to come from our Tulsa and Woods Cross refineries to replace some of the current feedstock and make more Group III, Group III+ higher-margin oils and therefore, also more higher-margin finished lubricants and specialty products out of the Mississauga facility.

Paul Cheng - *Barclays Capital - Analyst*

George, can you remind me, I thought Tulsa is a Group I base oil business, right?

George Damiris - *HollyFrontier Corporation - President & CEO*

That's correct.

Paul Cheng - *Barclays Capital - Analyst*

And so -- that's why that I may be confused because I thought the Group III base oil and the group I, the market are totally different and that's also quite dramatically different. And I didn't realize that you can actually move from a Group I into a Group III with any meaningful or easy way to do so. Maybe I am probably just totally ignorant on that.

George Damiris - *HollyFrontier Corporation - President & CEO*

No, I think what you are doing, Paul, is I think you are anchored on the engine oil lubricant market. Remember, both our existing Tulsa business and this Petro-Canada business makes a lot of specialty products that don't end up in automotive engine oils. So to the extent, again, that we can place some of our specialty lubricant products out of Tulsa in other specialty formulations in Petro-Canada's portfolio, that's what we are talking about.

Paul Cheng - *Barclays Capital - Analyst*

I see. All right, thank you.

George Damiris - *HollyFrontier Corporation - President & CEO*

Sure, Paul.

Operator

Brad Heffern.

Brad Heffern - *RBC Capital Markets - Analyst*

Hi, everyone. Doug, one for you maybe. I was curious on the working capital side. Is that basically the amount of working capital the business needs? Or is there a chance that you were able to draw that down some?

Doug Aron - *HollyFrontier Corporation - CFO*

I'm sorry, that we are able to draw it down in terms of minimize that working capital?

Brad Heffern - *RBC Capital Markets - Analyst*

Yes, exactly, because there'd be a working capital release where you're paying for this working capital but that moves down over time and takes care of some of the purchase price, is what I'm getting at.

Doug Aron - *HollyFrontier Corporation - CFO*

Oh, I think -- well, you can think about it in a number of different ways. I would tell you that obviously we haven't operated this business yet but we would assume that the current owner, albeit, a major oil company, probably thinks about that. There are certain financing alternatives or an opportunity for someone else to own that working capital. But in terms of cutting that number in half, probably a little too early to tell.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, got it. And then I was curious, George, you mentioned in your prepared comments, the Woods Cross expansion. Obviously there are issues with the feedstock there, but longer-term, does that project potentially come back with enhanced economics as a result of this deal?

George Damiris - *HollyFrontier Corporation - President & CEO*

I don't think that project comes back. And I think this deal would probably delay the timing even more, just because we already have a facility now that does what we had contemplated in the phase 2 expansion.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, understood (Multiple speakers).

George Damiris - *HollyFrontier Corporation - President & CEO*

Those molecules that we are talking about that come out of the wet food again, they're very paraffinic, which I know is probably more technical than I even want to get into. But it's very good feedstock for making Group III base oils and the portfolio of products that come out of Group III base oil. That's what attracted us to that phase 2 expansion. Again, that's one of the upsides for the feedstock replacement scenarios we've been discussing this morning.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, understood. And then from an administrative standpoint, how's the reporting going to work going forward? Is the lube business going to pulled out of Tulsa and you'll have a separate lube segment? Or is this going to be reported in refining somewhere?

George Damiris - *HollyFrontier Corporation - President & CEO*

We haven't worked through all those details yet, Brad, but I think we will give you enough visibility to see how much this business is contributing to the overall.

Brad Heffern - *RBC Capital Markets - Analyst*

Okay, thanks.

Operator

Doug Leggate.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Hi, good morning, everybody. I got a couple if, I may. The CapEx profile -- maybe this one is for Doug. You've given the historical stay-in-business capital, are there any material capital issues related to the turnarounds or anything specific we should be aware of? Or is $25 million annually going forward a good number?

Doug Aron - *HollyFrontier Corporation - CFO*

I think that's -- it depends on the turnaround. In a heavier turnaround year that's probably on the light end, but as an average, Doug, that's our expectation.

George Damiris - *HollyFrontier Corporation - President & CEO*

(Multiple speakers) there's no Tier 3 type of investments or any one-time type of catch-up capital or anything here, Doug.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay, thanks George. On that point, is there a turnaround schedule you can give us? When would we anticipate to have CapEx up and EBITDA down?

George Damiris - *HollyFrontier Corporation - President & CEO*

How about we give you that at a future call? I don't think we have it we -- we have it, we just don't have it readily available.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay, don't worry about it.

George Damiris - *HollyFrontier Corporation - President & CEO*

Most of the turnarounds have just taken, so it's not like they're facing a major turnaround in the near future either.

Doug Aron - *HollyFrontier Corporation - CFO*

Hey Doug, their last major turnaround was just last year, 2015, so we've got a few years there.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Got it, okay. Just a related question, if I may, obviously one of the attributes of lubricants is as a generic industry, is margin premium relative to refining, but also some relative stability. But looking at slide 11, that doesn't really help being the case here in terms of the volatility of the EBITDA. I understand you've given some explanations to Jeff's questions as to why that may have been the case, but what gives you confidence that EBITDA will be more stable going forward versus what it's looked like in the last five or six years?

George Damiris - *HollyFrontier Corporation - President & CEO*

Again, I think the major thing that drove the change in EBITDA that you see of that graph, is a huge chunk of Gulf Coast Group II capacity that came on stream. It was a huge increment capacity. I don't think we're going to see a big increment capacity to come into the Gulf Coast again anytime soon. And I think we've seen the bounce-back from the market absorbing that increment incapacity. The results also are reflected in the bounce-back of EBITDAs, the shift in strategy of Petro-Canada Lubricants to grow more towards the specialty and high-margin finished lubricants activity.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay. I probably want to take some of these off-line, but just a very quick follow-up on the speciality issues. A lot of the very high-margin lubricants players tend to tailor-make products for specific customers. Is this more a commodity lubricants business? Or is it very much in that tailor-made category?

George Damiris - *HollyFrontier Corporation - President & CEO*

It's pretty much in the Tailor-made, as you mentioned. The business has 50 R&D scientists, many of them, half of them have PhDs that are really working at the molecular level to develop specialty applications for specific customers. And a lot of the brand names would be in our slide deck, of the resulting products that was R&D efforts.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Got it, okay. Last one, if I may, just squeeze one final one in. Which is, obviously there's substantial increase this year lubricants scale but they're still a fairly fragmenting businesses. Do you see this as a starting point or maybe for additional opportunities to consolidate this industry? Or do you think this is really more a one-off and probably not a platform for growth?

George Damiris - *HollyFrontier Corporation - President & CEO*

No, absolutely. We view this as a solid growth platform from which we can continue to do other deals to grow the lubricants part of our business.

Doug Leggate - *BofA Merrill Lynch - Analyst*

I appreciate the answers, guys. Thank you.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thank you, Doug.

Operator

Chi Chow.

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

Great, thank you. Following up on Doug's question there. You describe this is a stable business, but why is your annual EBITDA guidance so wide? $100 million to $200 million?

George Damiris - *HollyFrontier Corporation - President & CEO*

We're basically trying to be pretty conservative here, Chi. If you want us to pick one number it would be definitely be $150 million per year. We want to make sure we put out a range that has at least two sigma worth of coverage there. We could price it definitely but working broad enough that we can cover a wide range of the spectrum.

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

Is the $20 million of synergies included in that guidance?

George Damiris - *HollyFrontier Corporation - President & CEO*

No.

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

Okay. Looking at your implied OpEx per barrel, given the size of the plant and the general margins you're talking about, it suggests that we're somewhere in the $80 per barrel range on OpEx. Is that right?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Chi, this is Rich. What you've got to remember here is that this is a fully-integrated downstream business. So I really don't think you can look at it that way. Plant OpEx is far, far lower than that. But we're talking about what really becomes a retail business as well here, so we're going to end up with acquiring in this process of a very talented sales force of over 200 people, for example. It's not a traditional pure manufacturing business, since to George's point, we're talking about a specialty formulations for specific customers.

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

Okay. So you've got a big G&A component, is that what you're saying?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Absolutely.

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

Okay. And on the margins, how do they vary by the product category you've got broken down here between finished and specialty and white oils? Is there big variability in the margins between products?

Doug Leggate - *BofA Merrill Lynch - Analyst*

Chi, I'm just going to -- look, when George mentioned a lot of products, PCLI has, I want to say something like 12,000 SKUs that they are producing currently. So each -- we're trying to bucket these for ease of consumption and analysis, if you will. But again, we're talking about a very wide range of very specialized products. So it's hard to -- we could be here for hours trying to walk through each specific product line.

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

Okay. Just a couple other questions here. What are the publicly-traded comps that you mentioned in the slide deck? And also, is there any MLP opportunity here?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

I was going to say, some of the comps that we've looked at -- we view this business as very similar to a specialty chemical business. So if you can look at a lot of those names and also there's a few lubricant businesses out there. It's probably not quite exactly the same as Valvoline, but that's been in the news lately.

On the MLP side, Chi, I don't think there's -- we don't see a day-one drop-down opportunity here. To George's point, we do see and we're going to be working very hard, the opportunities around optimizing feedstock here, which a lot of that is going to be driven by logistics over time. So we do see some opportunity for investment, but it's probably a little too early to start naming names and numbers.

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

Is there a drop-down opportunity in the future?

Rich Voliva - *HollyFrontier Corporation - SVP of Strategy*

Nothing immediate.

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

Okay, thanks. Appreciate it.

George Damiris - *HollyFrontier Corporation - President & CEO*

I think the other thing you got a remember too, Chi, is this is a Canadian business. So if we did drop it down -- anything drops down to HEP, we would have to fit it in the non-qualifying bucket.

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

Okay, great. Thanks, George.

Operator

Edward Westlake.

Edward Westlake - *Credit Suisse - Analyst*

Good morning. Thanks for the slide deck, lots of useful color. On the feedstock optimization, it sounds like there's something you could do with the black wax crude from Woods Cross to get it over to a feedstock to the plants. Any thoughts around that numbers that you could target for dollar millions over and above the synergy benefits?

George Damiris - *HollyFrontier Corporation - President & CEO*

No, I don't think we're going to go there this morning. But I will just say that even 1,000 barrels per day of feedstock replacement, basically what we're thinking here is we can shift the yields from Group II to Group III. And I'll leave that as an exercise to the student here to figure out what the difference is between Group II and Group III base oils and what the resulting EBITDA implications could be. But it's exciting. The potential is exciting.

Edward Westlake - *Credit Suisse - Analyst*

Thanks for the homework. On the slide on page 9, you've got that chart of Group III benchmark margins. And I know other folks have tackled this, but effectively you have a hangover from Pascagoula and then margins expanded.

But a lot of that, is that just related to the fact that crude prices fell over that period? Because as I get to Q2 and prices rally again, do you go back to the same sort of Group III margins we had earlier? Are we really seeing a healthier market? Or is this just the gyrations of the crude market? Any observations there?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, I think what you're saying is correct. There's some timing issues between the movements in crude prices and the movements in lubricant prices. When crude prices dropped, as you say, there's a lag. Lubricant prices are stickier. I think more important is what the long-term trend is still pretty consistent in these Group III base oils over that longer period of time, $130-ish per barrel. If you ignore the 2011 and 2012 side of the graph, it still a pretty good consistent number.

Edward Westlake - *Credit Suisse - Analyst*

As part of the deal process, did you do any analysis of globally new capacity additions? It's also something we'll run out and try and get ourselves, but any color in terms of how you see the global picture in terms of capacity additions for lubricants?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think there will be capacity additions. But more importantly, again, for us and for this business, is the demand side of the equation where the demand for Group III type of lubricants, because of the increasing DEP A standards will drive the overall supply-demand balance.

Edward Westlake - *Credit Suisse - Analyst*

And then final one for me, any comments on the process? Was it a competitive auction? Maybe some color there. Thanks.

George Damiris - *HollyFrontier Corporation - President & CEO*

No, I think it's always fair to assume that there was competition here. I think even with that competition, we think we bought a great business at a good price, again, about four times trailing 12-months EBITDA, excluding the working capital component.

Edward Westlake - *Credit Suisse - Analyst*

Thank you.

Operator

Neil Mehta.

Neil Mehta - *Goldman Sachs - Analyst*

Good morning, guys. The first question I had was in terms of a financing. I think, Doug, you had mentioned that you were conservative in terms of financing assumptions that you put on the slide. Can you flesh that out a little bit?

And then, as you think about this, how do you weigh this versus the buy-back in the sense that you had not delevered balance sheet, you are adding leverage to the business. Does this constrain the ability to be as aggressive on the buy-back with your shares having sold off?

Doug Aron - *HollyFrontier Corporation - CFO*

Neil, under the comment about conservatism around our financing scenario, so when we showed -- when I was describing during the presentation something between a 3% and a 20% or so accretion, that was assuming a fully debt-financed acquisition at something in the mid-5%s in terms of cost of that debt. The point was that we were showing that relatively conservatively in terms of the other alternative would have been to show using half cash or half debt, or really all of the cash on our balance sheet which would've goosed the accretion because you would have had the incremental cost of the debt.

On that debt side, as we said, talking about getting to that overall target level of about $1 billion of debt that was pre-acquisition we still see relatively similar levels post the acquisition. So, again, a debt-to-cap in that 19% range, so we think conservative. As it relates to the buyback, Neil, we had said until we got a little more clarity around free cash flow generation in our business, it was going to be something that we tapped the brakes on. You hadn't seen much in the way of share repurchase from us since February.

I don't think at all this acquisition precludes us from being back in the buy-back realm and I think maybe lost in a couple of the last questions and even this one as well, as it relates to where these margins in this business have been for the last couple of years and influence on oil prices, the fact that, again, when you exclude the working capital portion of this purchase, we're buying this lubricants EBITDA stream at roughly four times compared to some public company comps that are close to double that. Overall, very excited about what this means in the cash flow it will generate. We certainly hope that it and our base refining business return to free cash flow generation that we're more accustomed to that will allow us to buy back stock in meaningful amounts. But for right now, our focus would be in integrating this business.

Neil Mehta - *Goldman Sachs - Analyst*

That's great, Doug. More a request if anything, but just from a reporting standpoint, to the extent you guys can break out this business, I think it'd be very helpful for us following the Company and probably help you guys unlock some of that value for higher multiples. Any thoughts from a reporting standpoint would be appreciated, but I think that would be helpful.

Doug Aron - *HollyFrontier Corporation - CFO*

We hear your point, Neil, and know that. We visited with you and a group of investors not that long ago, and you asked what was the -- what do we think was one of the more misunderstood parts of our business. And we think that there wasn't much visibility at $100 million or so of lubricants EBITDA we're doing out of Tulsa. So your point is taken and the exactly how and what's reported is yet to be determined. But you can bet that this will be a lot more prominent and you guys will have some clarity as to what we're doing.

Neil Mehta - *Goldman Sachs - Analyst*

I appreciate it. Thanks, guys.

Doug Aron - *HollyFrontier Corporation - CFO*

Thanks Neil.

Operator

Faisel Khan.

Faisel Khan - *Citigroup - Analyst*

Thanks, guys, good morning. A couple questions. First of all, when I think about the production you guys have in Eastern Canada versus your competitors for base oil production on the Gulf Coast, is there a meaningful transportation differential or product realization based on your geography versus the Gulf Coast guys?

George Damiris - *HollyFrontier Corporation - President & CEO*

Well transportation is a key component of this business, no question, and it just depends on the market. There are huge finished lubricant markets that are closer proximity to this plant than the Gulf Coast, most specifically the East Coast and Chicago markets. So we will definitely have a competitive advantage in those separate markets.

Faisel Khan - *Citigroup - Analyst*

When you say export to 60% of production overseas is that -- is the US in that 60%,or is it --?

George Damiris - *HollyFrontier Corporation - President & CEO*

Yes, that's part of the 60%. I think the volume breakdown is roughly 40% US, 40% Canada and 20% Europe, with a few percentages in other locations.

Faisel Khan - *Citigroup - Analyst*

Okay, got you. And then when I think about this business compared to the large base oil plant that Chevron built in Pascagoula, I guess that cost of about $1.5 billion for 25,000 barrels of base oil production. Is that a comparable metric? Am I looking at basically -- if I look at Europe as acquisition of 15,000 a day in they're building 25,000 a day, it look like roughly a little bit less than replacement costs. Is that the right way to look at it? Or is there something embedded in the franchise value of the Company?

George Damiris - *HollyFrontier Corporation - President & CEO*

Just from a production facility perspective, that wouldn't it be a bad first cut at it, but there's so much more that were buying here in addition to the steel that makes these base oils.

Doug Aron - *HollyFrontier Corporation - CFO*

Faisel, keep in mind working capital is not part of construction costs for example. To George's point, we acquired, just one example, exclusive perpetual license to Petro-Canada brand which has enormous value to us going forward. And they're going to be great partners to work with in some corner of Petro-Canada retail business. Those things which don't have a replacement cost, per se, but represent enormous value.

Faisel Khan - *Citigroup - Analyst*

Okay.

George Damiris - *HollyFrontier Corporation - President & CEO*

Just backing out to the working capital, like we talked about, $600 million or less to compared to your newbuild economics.

Faisel Khan - *Citigroup - Analyst*

Okay. And I look at the product breakdown you guys give in the pie chart between base oils and finished lubricants, is it fair to say that the plant -- the downstream processing units manufacture the finished lubricants, you start with the base oil, call it 73% base oil, then 32% is what the downstream processing it is to get to the 32% finished lubricants?

George Damiris - *HollyFrontier Corporation - President & CEO*

All of the products that are on that pie chart on page 8, Faisel, start as base oils. Then those base oil mono fuels are then sold into different markets that are basically that pie chart.

Faisel Khan - *Citigroup - Analyst*

Okay. I got you. In terms of comps, Phillips sold their specialty chemicals business to, like I said, a division of Lubrizol. Is that the right comp in terms of the business, so this is too?

George Damiris - *HollyFrontier Corporation - President & CEO*

I think so. Again, these businesses are combinations of lubricants business and specialty chemicals. So it's, again, high single-digit to double-digit type of EBITDA multiples for these types of businesses.

Faisel Khan - *Citigroup - Analyst*

Okay, thank you. I appreciate the time.

George Damiris - *HollyFrontier Corporation - President & CEO*

Thank you.

Operator

Paul Sankey.

Paul Sankey - *Wolfe Research - Analyst*

Hi, everyone. George, I think that this question has been asked before but there were a little bit of surprise when you came onboard and talked about acquisitions. Can you talk -- again, I know you've addressed this, but can you talk again about how many more acquisitions or how much more appetite you guys have to do deals, given this one is, I think, in many ways going to relieve an overhang on this job because it's not a crazy refining deal? Thanks.

George Damiris - *HollyFrontier Corporation - President & CEO*

Again, I think, Paul, we would still consider ourselves to be in the market for other deals. The constraint here is, again, future resource, not money. There's money available to do good deals. We will keep looking, but realistically we want to focus on properly integrating this business into HollyFrontier. That's going to be our clear number-one priority moving forward. We will keep looking at what's in the market but it has to be even more compelling than -- it would have to have been prior to this deal for us to do another deal on top of this one because of our focus on integration.

Paul Sankey - *Wolfe Research - Analyst*

Yes, I understand that. It sounds like, again, when I know that you have excellent human resources, such as Mr. Voliva and others. It sounds like we're in a pause for a year or so, but beyond that you would be looking at other stuff. Can you talk about the long-term vision for HollyFrontier that you have? Thanks.

George Damiris - *HollyFrontier Corporation - President & CEO*

(Laughter) Our vision is basically to double the size of our Company by the year 2020, plain and simple. When I say our Company, I'm talking about our refining business, our midstream business through HEP, as well as our lubricants business. And Rich and the team have done a good job of doubling the size of our lubricants business with this deal alone. So we're going to reset and say that we want to double yet again, since we have a few years before we get to 2020.

That's what we're trying to at HollyFrontier, is to continue to do deals so we can grow our Company for the benefit of all of our stakeholders and shareholders, but also our employees and the communities in which we operate. That's what we're all about and that's what we're looking at.

Paul Sankey - *Wolfe Research - Analyst*

Okay. I understand that but why would you -- why double? What's the rationale for that?

George Damiris - *HollyFrontier Corporation - President & CEO*

It's just a goal to shoot for. There's nothing overly fancy to think about it.

Paul Sankey - *Wolfe Research - Analyst*

Okay I will have to go home and think about that.

Operator

There are no other questions. I will turn the call back over to Julia Heidenreich.

Julia Heidenreich - *HollyFrontier Corporation - VP of IR*

Thank you, everybody, for joining us today. I know it's busy earnings season. We'll speak you in a couple days with our third-quarter earnings and of course, as always, if you have any follow-up questions, Investor Relations will be available all day.

Operator

This concludes today's conference call. You may now disconnect.
