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CVI - Q2 2019 CVR Energy Inc Earnings Call

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PRESENTATION

Operator

Greetings, and welcome to CVR Energy's Second Quarter 2019 Conference Call. (Operator Instructions) As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Jay Finks, Vice President of Finance and Treasurer.

Jay Finks - *CVR Energy, Inc. - VP of Finance & Treasurer*

Thank you, Dana, and good afternoon, everyone. We very much appreciate you joining us this afternoon for our CVR Energy Second Quarter 2019 Earnings Call. With me today are Dave Lamp, our Chief Executive Officer; Tracy Jackson, our Chief Financial Officer; and other members of management.

Prior to discussing our 2019 second quarter results, let me remind you that this conference call may contain forward-looking statements as that term is defined under federal securities laws. For this purpose, any statements made during this call that are not statements of historical facts may be deemed to be forward-looking statements. Without limiting the foregoing, the words outlook, believes, anticipates, plans, expects and similar expressions are intended to identify forward-looking statements.

You are cautioned that these statements may be affected by important factors set forth in our filings with the Securities and Exchange Commission and in our latest earnings release. As a result, actual operations or results may differ materially from the results discussed in the forward-looking statements. We undertake no obligation to publicly update any forward-looking statements whether as a result of new information, future events or otherwise, except to the extent required by law.

This call also includes various non-GAAP financial measures. The disclosures related to such non-GAAP measures, including reconciliation to the most directly comparable GAAP financial measures, are included in our 2019 second quarter earnings release that we filed with the SEC.

With that said, I'll turn the call over to Dave.

David L. Lamp - *CVR Energy, Inc. - President, CEO & Director*

Thank you, Jay. Good afternoon, everyone, and thank you for joining our earnings call. Hopefully, you had an opportunity to listen to the CVR Partners earnings call earlier today.



Yesterday, we reported second quarter consolidated net income of \$128 million as compared to \$68 million in the second quarter of 2018.

EBITDA for the second quarter of '19 was \$273 million compared to \$180 million for the previous year. The year-over-year EBITDA improvement was driven by safe, reliable operations, low RIN prices, wide Brent-TI differentials, higher crack spreads, increased fertilizer sales and -- sales volumes and price and a gain on our Cushing tank farm sale.

We also announced a second quarter dividend of \$0.75 per share, which will be paid on August 12 to stockholders of record on the close of the market on August 5. On an annualized basis, our current dividend of \$3 per share represents an industry-leading dividend yield of approximately 5.5% based on yesterday's close price.

For our Petroleum segment, both plants ran well operationally despite record levels of rainfall and flooding conditions that persisted through the quarter. The combined total throughput for the second quarter of '19 was approximately 216,000 barrels per day compared to 218,000 barrels per day in the second quarter of '18.

The Group 3 2-1-1 crack spread averaged \$20.67 per barrel in the second quarter of '19 as compared to \$19.18 per barrel for the second quarter of '18. Crude differentials remained favorable during the quarter, with the average differential between Brent and TI remaining over \$8.50 per barrel or approximately \$1.50 per barrel wider than the second quarter of '18.

The WCS differential tightened relative to the second quarter of '18 to \$12.63 per barrel, largely as a result of the continued production curtailment imposed by the Alberta government.

The Midland differential to Cushing also narrowed to \$2.27 per barrel in the quarter. Light product yield for the quarter was 98% on crude processed. Our distillate yield as a percentage of total crude oil throughput was 44% in the second quarter of 2019, slightly below prior year's period, mainly due to the runoff of naphtha built during the Wynnewood turnaround late in the first quarter, early second quarter. Our distillate yield consistently ranks in the top quartile among U.S. independent refiners.

In total, we gathered approximately 120,000 barrels a day of crude oil during the second quarter of 2019 as compared to 111,000 barrels for the same period last year.

As we continue to shift our slate to crude oils gathered in our own backyard, we have increased SCOOP gathering in runs by over 25% relative to the second quarter of '18. As we increase our crude oil gathering in the SCOOP, we have reduced gathering activities in other nonstrategic areas as well as our purchases of Cushing common crude.

During the second quarter, the Fertilizer segment had a strong, reliable operations at both facilities. Coffeyville's ammonia unit operated at 97% utilization in the quarter, well above the utilization of the second quarter of '18, which is impacted by both planned and unplanned downtime.

At East Dubuque, the ammonia plant operated at 98% utilization, which was also higher than the prior year period. Low natural gas prices, combined with strong demand and constrained river movements resulted in Fertilizer's solid contribution to CVR Energy's consolidated results.

Board of Directors for the CVR Partners general partner declared a second quarter 2019 distribution of \$0.14 per common unit, which will be paid on August 12 to unitholders of record at the close of the market on August 5. As CVR Energy owns approximately 34% of the common units of CVR Partners, we will receive proportionate cash distribution of approximately \$5 million.

Now let me turn the call over to Tracy to discuss our financial highlights.

Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

Thank you, Dave, and good afternoon, everyone. We reported consolidated net income of \$128 million in the second quarter of 2019 as compared to \$68 million in the prior year period.

Diluted earnings per share was \$1.16 for the second quarter of 2019 compared to \$0.50 for the prior year period. The effective tax rate for the second quarter of 2019 was 24% compared to 18% for the prior year period. The increase in income tax rate was due primarily to the decrease in noncontrolling interest as a result of the first quarter equity transaction. We continue to expect that our full year 2019 effective tax rate will be between 20% and 25%.

The Petroleum segment's EBITDA for the second quarter of 2019 was \$216 million compared to \$164 million in the same period in 2018. The increase in EBITDA year-over-year was driven by low RIN prices, higher crack spreads and the gain on the Cushing tank farm sale. In the second quarter of 2019, our Petroleum segment's refining margin, excluding inventory valuation impact, was \$15.68 per total throughput barrel compared to \$13.03 in the same quarter of 2018.

The slight decline in crude oil flat price through the quarter generated a negative inventory valuation impact of \$0.02 per barrel during the second quarter of 2019. This compares to \$1.10 per barrel positive impact during the same period last year. The capture rate, excluding the inventory valuation impacts, was 76% in the second quarter of 2019 as compared to 68% in the second quarter of 2018.

The total derivative gains for the second quarter of 2019 totaled \$4 million, which includes unrealized gains of \$2 million associated with open purchases of Canadian crude oil that are scheduled for future delivery.

In the second quarter of 2018, we had a total derivative gain of \$10 million, which included \$7 million of unrealized losses at the end of the quarter. RINs expense in the second quarter of 2019 was \$21 million or \$1.05 per barrel of total throughput compared to \$50 million or \$2.51 per barrel of total throughput in the same period last year.

Based upon recent market prices of RINs and current production plans, we estimate that our RINs expense will be approximately \$70 million to \$80 million in 2019, excluding any potential reductions in renewable volume obligation. In addition, we expect every \$0.05 move in the price of RINs to result in \$10 million to \$15 million impact to our annual RINs expense.

The Petroleum segment's direct operating expenses were \$4.40 per barrel of total throughput in the second quarter of 2019 as compared to \$4.68 per barrel in the prior year period. The decrease was primarily associated with lower environmental accrual.

For the second quarter of 2019, the Fertilizer segment reported operating income of \$35 million and net income of \$19 million or \$0.17 per common unit. This is compared to second quarter of 2018 operating losses of less than \$1 million and a net loss of \$16 million or \$0.15 per common unit.

Adjusted EBITDA was \$60 million in the second quarter of 2019 compared to \$26 million for the prior year period. This year-over-year increase in adjusted EBITDA was primarily due to a 28% increase in total sales volume and improved pricing of 31% and 14% for ammonia and UAN, respectively.

Total consolidated capital spending for the second quarter of 2019 was \$22 million, which included \$17 million from the Petroleum segment and \$2 million from the Fertilizer segment. Of this total, environmental and maintenance capital spending comprised \$20 million, including \$15 million in the Petroleum segment and \$2 million in the Fertilizer segment.

We now estimate the total consolidated capital spending for 2019 to be approximately \$160 million to \$180 million, of which approximately \$140 million to \$150 million is environmental and maintenance capital. This includes planned turnaround -- excludes planned turnaround spending, which we estimate will be approximately \$50 million to \$55 million for the year.

Our cash position remained strong as we ended the quarter with cash of approximately \$540 million on a consolidated basis, which includes \$69 million in the Fertilizer segment. We continue to feel confident on our strong balance sheet and liquidity position.

Looking ahead, we estimate our total throughput for the third quarter of 2019 to be approximately 215,000 to 225,000 barrels per day. We expect total direct operating expenses for the third quarter to be approximately \$90 million to \$100 million and total capital spending to range between \$40 million and \$60 million.



With that, Dave, I'll turn the call back to you.

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Thank you, Tracy. In summary, we are proud of our strong results for the second quarter of 2019. Our mission continues to be a top tier North American petroleum refining and fertilizer company as measured by safe, reliable operations, superior financial performance and profitable growth.

Looking at the second half of 2019 and beyond, we currently see a host of market themes that drive our outlook.

One, domestic crude oil, and specifically light crude oil production, continues to increase. Recent data from EIA shows year-over-year crude oil production growth from the major shale oil basins of over 1.2 million barrels per day.

Two, the Brent-TI spread remains healthy, although the Midland-Cushing differential has compressed with line fill on new pipelines.

Three, gasoline demand remains strong with the latest data showing vehicles miles traveled in the U.S. up by 1% -- over 1% year-over-year.

Four, product exports have been steady.

Five, RIN prices have increased recently but are still fairly low.

Six, IMO 2020 is less than 6 months away, and we continue to believe these new standards will represent a tailwind for the refinery industry in general.

Seven, Tier 3 gasoline specification change -- changes will also be fully implemented by January 1, 2020, which likely represents another tailwind for the refining industry, especially for those refiners that are prepared.

Eight, continued low natural gas prices benefit both our refining and fertilizer business.

And number nine, due to the wet weather and flooding in the spring, we should see lower-than-expected planted corn acres and yields, resulting in decreased corn inventories. This has driven an increase in corn prices and bodes well for the future fertilizer demand as future corn acres planted should increase and farmers should seek to maximize yields.

We believe CVR Energy is well positioned for the balance of 2019 and beyond, and we continue to make progress on our strategic objectives. In support of these objectives we have a number of initiatives that we are progressing, as previously discussed in our first quarter earnings call. We would like to provide some updates on those initiatives today.

First, the board has approved Schedule A engineering design work for the Coffeyville crude optionality project. This project would increase the capacity of processing natural gasoline to 10,000 barrels per day. Natural gasoline spreads to regular subgrade are in the \$0.70 range today and are expected to widen further with the implementation of Tier 3 gasoline specs.

Second, we completed our sale of the underutilized Cushing tank farm assets as planned for a consideration of \$44 million, including inventory.

Third, we increased our ability to produce premium gasoline at Wynnewood as a result of the Benfree repositioning project and the installation of the new generation of catalysts. We have also changed the reformer catalyst at Coffeyville, which also should increase our premium production there. Premium spreads in the group have averaged \$0.26 in the second quarter of 2019 and have averaged \$0.40 quarter-to-date. The prompt prices are more like \$0.55.

Fourth, Schedule A engineering design work is progressing on the new C5/C6 isom at Wynnewood, which should also improve capture rate via more premium production and improved liquid volume yield.

Fifth, Schedule A process engineering work is also underway to replace the hydrofluoric acid catalyst in the Wynnewood alkylation unit with a solid catalyst. This project is also expected to increase premium production at Wynnewood.

And finally, we initiated a bank process to evaluate potential strategic alternatives for the company. As we have further defined our capital project plans, we have reduced our capital spending plan for 2019 by approximately \$50 million to \$60 million to reflect the timing of certain projects that have shifted into later years.

Looking at the third quarter of 2019, the second quarter to date -- quarter-to-date, Group 3 cracks 2-1-1 have averaged \$19.35 per barrel, with the Brent-TI spread at \$6.57 per barrel and the Midland-Cushing differential at \$0.75 per barrel. Ethanol RINs are \$0.22 quarter-to-date compared to \$0.17 in the second quarter, and biodiesel RINs are at \$0.41 compared to \$0.38 in the last quarter.

With that, operator, we're ready for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Prashant Rao with Citigroup.

Prashant Raghavendra Rao - Citigroup Inc, Research Division - Senior Associate

I wanted -- I have a couple of questions on operations in the quarter, but sort of wanted to address something else first, which is the exploratory process for strategic units -- alternatives for the company and sort of just get an update on where we stand on it. There's 2 sort of things I wanted to address on that -- get your take on. One is there has been speculation in the market or looking at where you trade versus peers, it might be attractive for CVI potentially to be a consolidator in the market. I wanted to sort of get your thoughts around that with arbs staying wide here.

The second is that given where the share price is and that supported by a strong dividend yield, we are sort of at a share price where, like previously indicated, we were -- it would have been minimally acceptable, almost minimally acceptable for a sale of the company. So I wonder if that -- how that plays or how shades the thought of selling the company given that you have strong cash flows, you have a good dividend yield, as a going concern the company is robust. So just wanted to get updated thoughts around both of those factors and overall on the process?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, most I can probably say on that subject is really that we just started this bank process and we're just into it now. And it's really premature to make any conclusions from it at this point. I think as I have stated before, the timing of the offering is based on really the tailwinds of the industry and what we see coming forward, and believe that it's a reasonable time to make this offering. I can't explain exactly why the stock has done what the stock has done, but I'm glad for it. And we look forward to exploring all the options available to us in the future, and that's what we'll do through -- via this bank process.

Prashant Raghavendra Rao - Citigroup Inc, Research Division - Senior Associate

All right. I appreciate that you're sort of constrained in how you can answer that, the color is helpful. Operationally and maybe turning to first Petroleum and then to the fert segment. On the Petroleum segment, I wanted to get a sense of how much the narrowing in WCS spread sort of was a headwind? As I look ahead, we're expecting WCS to widen out as rail movements start growing, seems like that's more probable increasingly every day as we look at all the factors and in view of what the government is doing up there. How much could that help in 3Q and in the back half? And is that something that you're also expecting in kind of the list of factors that keep you positive and constructive is -- how should we be thinking about that cadence there from where you sit?



David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, ultimately, I think the WCS has to price, or the Canadian crudes have to price, at their rail alternatives. Today, it's barely covering that if covering it at all. I think it's more driven right now by the constraints the government has on production. At some point, I got to think they will let that go. But then rail will take over and I think what you're seeing in the future is it's trying to price it -- the rail alternative in that \$20 range. So that's kind of our view going forward. It is just as we would say on the Brent-TI, ultimately, it trades to the transportation alternative.

Prashant Raghavendra Rao - Citigroup Inc, Research Division - Senior Associate

Would you be taking advantage of hedging or derivative strategies on that forward discounting? Is that something we should be thinking about in terms of your earnings going ahead or are we -- I know your policy has been a little bit more light on the hedging and derivatives activity than from previous years? But I just wanted to get a sense if the opportunity is there, would you be tactical?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

My philosophy on hedging is hedge when it adds value. And that's a pretty tough standard to live to. That's why you've seen us reduce our activity in that area. On the other hand, we do see some positive arbs just thinking about the government's influence on WCS, where most likely they'll get it wrong. And we've seen that so far just because the futures have been trading out in the \$20, \$22 range and every month it rolls over, it just rolls over to a higher price. And we are looking at taking advantage of some of those kind of opportunities, but that would be about it.

Prashant Raghavendra Rao - Citigroup Inc, Research Division - Senior Associate

Okay, and last question on the fert segment. Great performance this quarter; I think you geographically were helped positioning wise up at Dubuque. I just wanted to get a sense thinking ahead, yes, we've been -- this sort of stands in contrast to the macro news we've been hearing with affecting the energy industry from -- ag, all the flooding in the Midwest affecting planting this season and lot of farmers taking insurance payments and sort of calling it a year. I wanted to get a sense of what this means, if there is anything to think about the back half in terms of demand for your Fertilizer segment? And then as we roll forward to 2020, is there a reversal where we get a tailwind here as farmers come back to market and we -- hopefully without any outsized weather event, we're back to more of a normalized year? So just wanted to get a sense around your planning around that over the next couple of quarters and then as we look out in the next year?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

I think our view of that is that -- just look at the corn price has gone up almost abut. And that really is reflecting that there is, as I said in my opening remarks, is the yield should be fairly poor. I mean the government even projecting a \$1.66 on yield per bushel per acre. That's down from \$1.76, but we really think they're overstating even the \$1.66, and they're certainly overstating the number of acres that actually got in. Just -- we can just tell that by our own demand. But the second quarter was very good to us because we -- the river constraints really added value to what -- and we were able to sell at pretty high rates, both ammonia and UAN, and keep our inventories under control. So I think we're well positioned for what should be a very good planting season next year assuming the weather cooperates, which is hard to predict.

Prashant Raghavendra Rao - Citigroup Inc, Research Division - Senior Associate

Is there any effect to think about the back half of this year from -- versus usual demand -- or are -- I mean you were pretty relatively insulated in 2Q versus the rest of the market, a lot of that the agri market. Now should we continue to sort of expect that or is there -- would this creep in a little bit? Out of conservatism, should we think that some of that demand falloff creeps in a little bit in the back half of this year before things get good in 2020?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Yes, it's always hard to say, but I think just the fact that when the price goes up like this, the farmers tend to plant more corn. And this is a historic -- I mean it's probably a 5-year peak on prices. So I really think they're going to plant a lot of corn versus beans. And that bodes well for our business, particularly in the regions we're in.

Operator

Our next question comes from the line of Neil Mehta with Goldman Sachs.

Neil Singhvi Mehta - Goldman Sachs Group Inc., Research Division - VP and Integrated Oil & Refining Analyst

Congrats on the great share price performance this year. I guess a couple of follow-up questions. First on the comment that you made around Brent-WTI and ultimately, Dave, you think it trades towards transportation economics. Can you just talk about how you think the Brent-WTI spread will evolve over time? And how do you think about what normal is? What are the legs that ultimately define Brent-TI once all these Permian pipes come online?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Okay, Neil. My view of the Brent-TI is really driven by shale oil production. And as long as we have 1 million, 1.5 million barrels coming on a year and even with the pipes that are about to be in the ground and operating, I just can't find a way that that barrel -- to clear those barrels isn't going to mean a discount between Brent and WTI. And I particularly would say that's even more true for TL -- WTL and the new WTC that's about to come out. That's going to make a big difference in also in what -- now we're going to have to talk about 3 grades rather than 1, and the [lengths] of each one of those. And each of those bode well no matter what the Brent-TI does for us because we're processors of the lighter-type barrel.

Neil Singhvi Mehta - Goldman Sachs Group Inc., Research Division - VP and Integrated Oil & Refining Analyst

And what do you think West Texas Light will trade at relative to, let's say, a Midland barrel over time given the quality differential?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, I think my answer to that would be look at the production forecast of the 44 to 50 gravity-type material coming out of the Permian Basin, number 1, but also out of the -- at Anadarko basin. And I think you'll find that there is 1 million, 2 million barrels a day coming, and finding a home for that is not going to be easy in the Gulf Coast. And I think a lot of that will have to go offshore and that plays right into the Brent-TI spread ultimately -- the realized Brent-TI spread for us.

Neil Singhvi Mehta - Goldman Sachs Group Inc., Research Division - VP and Integrated Oil & Refining Analyst

So I mean, the forward curve looks something like \$5 to \$6 a barrel for Brent-WTI. Is that kind of how you guys think about what normalized transportation economics are?



David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, I think normalized transportation is probably more in the \$3.50 range. But I think to clear the barrel, just what I said, Neil, there's so much of it coming, assuming there is not -- it's not a \$30 WTI price, which I don't think the world can sustain the kind of growth in oil production to meet demand at a \$30 price. So it won't stay there long if it does get there. And even in the \$55 range, these -- a lot these plays are very profitable.

Neil Singhvi Mehta - Goldman Sachs Group Inc., Research Division - VP and Integrated Oil & Refining Analyst

Okay. All right. Well, that's helpful. And then the follow-up is just around the dividend and capital returns to shareholders. So you stepped the dividend back up to the \$3 share level. How do think about the dividend per share growth from here, especially given share price appreciation, recognizing it's a board decision, but should we view the dividend as a growing level over time, or do you see it kind of flatlining for here and hope the stock kind of grows into the dividend?

Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

I think we'll continue to evaluate that. We currently, with the \$0.75 per share quarterly dividend and \$3 a year, have an industry-leading dividend yield. And so we are evaluating that along with a number of high-return capital projects that Dave outlined on the call. And so we will continue to discuss that with the board and make sure that we put the cash to meaningful use going forward.

Neil Singhvi Mehta - Goldman Sachs Group Inc., Research Division - VP and Integrated Oil & Refining Analyst

Last one for me. Is there -- as part of the strategic review, obviously, the sale of the company and potential acquisitions of other entities is clearly part of it. Is selling noncore assets part of the discussion as well?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, it would be part of the discussion, but I don't know that we have any that we haven't dealt with. Maybe one left to go, but with the Cushing asset -- the Cushing tank farm was mainly a contango play and it just sat there, basically, in my opinion. So I think we've dealt with a lot of that already, Neil. I think there are some questions around what we would do with UAN, the fertilizer business versus refining. And that will just play out as it does depending on what we do on the bank process.

Operator

Our next question comes from the line of Paul Cheng with Scotia Howard Weil.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

A quick question. On the third quarter guidance for the OpEx, \$90 million to \$100 million, that seems high comparing to what you've been able to do. Is there any particular reason why that it would be higher than, let's say, for the last several quarters?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

I don't have any specifics to outline on that. Tracy, you...



Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

Predominantly maintenance projects that will be completed. Maintenance and repair projects that will be, just from a timing perspective, are hitting in the third quarter.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

Tracy, those are not being capitalized?

Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

Not maintenance and repair, no.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

Okay. Which facilities those are hitting?

Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

Well, we have maintenance and repair projects that run across the portfolio on a continuous basis, so it's both.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

Okay. All right. That's fine. Then maybe that, Dave, you can remind me, the crude optionality project, what's the total CapEx and timing as far as the yield?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

The total capital is around \$200 million. And the timing is the end of '22.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

Is it going to be 2 phases or that you're going to do all at once?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, this is really just Phase 1. If you remember what we talked about in the past was there is a Phase 2 that involves gas oil hydrotreater, which is really a play around increasing our ability to process WCS to 40,000 barrels a day. We don't see the need to do that right away until we really get definition on the future of sulfur credits and other factors around Tier 3 gasoline.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

Okay. So this is still talking about, previously you referred to just the Phase 1, not the entire projects?



David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Yes. Really Phase 1 is just -- is really just doing the Schedule A engineering there. It will require further approvals by the Board, but the project's really pretty strong, 30-plus percent return. And it's strategic in nature because of just, as I mentioned, Tier 3 gasoline specs. We believe natural gasoline is going to get very cheap, even cheaper than it is today, just because relatively high sulfur can't be blended without being treated.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

And given that is actually going to increase your gasoline yield, right, if I recall correctly, and in the market that there seems to be a concern gasoline is going to be in excess supply. Are you concerned that that may actually hammer on the local market profitability?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, a lot of those barrels are getting in there today, Paul. So I don't view it as a big increase, although I do share your concern. But remember, for the most part, the mid-con is an import market with Explorer Pipeline. Maybe not the winter, but it certainly is in the summer. So, I don't think...

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

That being my concern that during the winter, it seems like in the last couple of years, actually last 4, 5 years, the market has become very choppy. Clearly, it showed that with all the debottleneck and everything going on during the winter time, this is no longer importer market.

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Yes, that's correct. It's an export market. But remember, utilization remains high in the mid-con and it will. And it manifests itself on the wide Brent-TI spread. But I still -- I'd still say -- I will still tell you that a lot of these barrels are already being placed into the market today. They just won't fit in the future with Tier 3 gas specs.

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

And how much is the -- can you just remind me, how much is the increase in the gasoline supply? And is it going to have any additional supply increase?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, again, our ability to process 10,000 barrels of natural gasoline is basically you treat it and -- hydrotreat it and isom it and then you put it right to gasoline. So it's a barrel to barrel...

Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

So you basically increase that by 10,000 barrel per day of gasoline?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

No, because we run some today. We run about 3,000 barrels a day today.



Paul Cheng - Scotia Howard Weil, Research Division - Research Analyst

So about 7,000, but they have no impact on the jack and the diesel?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

That's correct.

Operator

Our next question comes from the line of Matthew Blair with Tudor, Pickering, Holt.

Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research

Dave, you mentioned Tier 3 as a potential tailwind. Could you talk about where you currently stand on Tier 3 compliance? And perhaps share any specifics around your outlook for octane premiums in 2020? Do you expect it to get back up to what we saw in 2015?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Sure. Well, let's talk about -- take the first part, is where is the industry at. I think you -- and I mentioned in my opening remarks that for those refiners that are prepared for this, it's going to be very lucrative, I think. And for those that aren't, it's going to be very expensive. So that is a question of who is ready and who isn't. In our case, we already make 10 ppm at the Wynnewood refinery. And we are still using credits at the Coffeyville refinery to blend down, but it doesn't take a whole lot for us to get there where we are today. We're probably running in the 18 to 20, 25 range and so it's not a big move for us. And also with what we've done on the benzene repositioning and these new technology catalysts -- or new generation catalyst we put in our reformers, we have the ability to make a lot of octane that historically we haven't made. So I think we're really well positioned for it. And as I mentioned in my remarks also, we had -- we have premium spreads to subgrade right now of \$0.55 in our markets. And I'd just kind of -- I don't know if that is an anomaly, as I mentioned quarter-to-date, it's more like \$0.41. But it's marching up. And I think it just gets worse as people run out of credits and certainly by January 1 of 2020, there isn't going to be the option or credits are going to be very expensive to buy. And that's just going to -- that's going to take away octane from the pool.

Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research

Right. Right. Okay. Sounds good. Your Midland barrels at Coffeyville were much lower than previous quarters. I was wondering if this might be a case like what you're doing with WCS, where you still pipe the same amount of barrels but then you resell it at Cushing. Is that the case or did you actually reduce your piped volumes of Midland in the quarter?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Well, remember, we had a turnaround at Wynnewood, which while we were down at the Wynnewood or cut back at Wynnewood -- I shouldn't say we weren't down all the way, but we were shipping those barrels towards Coffeyville. And then as we came out of turnaround, as I mentioned, we had high naphtha inventory because we had the reformer down. And it took us about a couple of months to run that off. So we were cut back. And that's part of it. And the other part is just the sheer increase we've seen in production out of the SCOOP is the rest of the barrels. So we actually ended up selling Midland and running this as the best alternative for us. And that's why you saw the big increase in Coffeyville. Our plan long term is to get as much as possible up the Red River line, fill the Red River line up and need more capacity until we can back out all the Cushing common we've been buying and do our own blending in essence for Coffeyville.



Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research

Okay. So I guess just to clarify, you're saying that you're still economically exposed to, I think it's like around like usually like 35 or 40 a day of Midland, even though the refineries only ran, I believe, about 14 a day in the quarter?

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Yes. We were -- we have the historical line space of about 30. And we get pro-rated a little bit because basis is full. So I think the actual number is around 28, 27. And then we ran some of it and sold the rest with a better alternative with the STACK condensates and lights.

Matthew Robert Lovseth Blair - Tudor, Pickering, Holt & Co. Securities, Inc., Research Division - MD of Refining and Chemicals Research

Got it. Okay, and then last question, I think, probably for Tracy, the depreciation has moved up quite a bit over the past couple of quarters. Is this due to the new accounting policy of capitalizing turnarounds? And is that \$76 million, is that a good number to use going forward?

Tracy D. Jackson - CVR Energy, Inc. - Executive VP & CFO

Yes, it is. At the beginning of the year, we began capitalizing our turnaround expense and then we filed a recast 10-K for reference purposes. And so that will look like our more normal run rate going forward.

Operator

Ladies and gentlemen, we have reached the end of the question-and-answer session. And I would like to turn the call back to management for closing remarks.

David L. Lamp - CVR Energy, Inc. - President, CEO & Director

Again, I'd like to thank all of you for your interest in CVR Energy. Additionally, I would like to thank our employees for their hard work and commitment towards safe, reliable and environmentally responsible operations. We look forward to reviewing our third quarter results during our next earnings call. Thank you.

Operator

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation, and have a wonderful day.

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