SHOP AROUND – THE REFINERIES ON THE BLOCK IN THE WESTERN U.S. (PART 2)

February 3, 2020

Over the weekend, PBF Energy closed on its acquisition of Shell's Martinez, CA, refinery, marking the first completed U.S. refinery transaction of 2020. The closure of that deal may seem unremarkable, but it's rare for more than two to three transactions involving individual refineries to take place in the U.S. in a given year, and there are as many as eight other refineries on the market. These include two each in the Philadelphia area, the Midcontinent and the Rockies, and one each in Washington state and Alaska. Why are so many refineries on the block? Today, we continue our series with a look at the facilities said to be on the market in PADDs 4 and 5.

As we said in Part 1 of this two-part blog series, all but a handful of the 135 refineries in the U.S. were built prior to 1970 – some as early as the late 1800s. For a variety of reasons, the best of these facilities tend to operate for long periods of time without frequent changes in ownership. Since 2013, excluding mergers and spinoffs of companies, an average of ~2 refinery transactions have taken place per year. In Part 1, we focused on the refineries for sale in PADDs 1 and 2. These included the two Philadelphia-area refineries looking for buyers: (1) Philadelphia Energy Solutions' 335-Mb/d, fire-damaged PES facility, which has since announced a potential acquisition by Hilco Redevelopment Partners, and (2) Delta Air Lines' subsidiary Monroe Energy's 185-Mb/d refinery in Trainer, PA. We also discussed two Midcontinent-area refineries owned by CVR Energy: the 132-Mb/d Coffeyville, KS, refinery and the 75-Mb/d Wynnewood, OK, plant.

Today, we turn our attention to four refineries located farther west. We begin with two in the **Rockies**:

- ExxonMobil is reportedly shopping its 60-Mb/d Billings, MT (bright green rectangle with dashed outline and dot in Figure 1), refinery to potential buyers. The refinery was built by Carter Oil Co. in 1949 and was eventually folded into the ExxonMobil umbrella through legacy companies such as Standard Oil and Humble Oil.
- Marathon Petroleum Corp. (MPC) is said to be evaluating a potential sale of its 61-Mb/d Salt Lake City, UT, refinery (dark green rectangle with dashed outline and dot). MPC has owned the refinery since the company's 2018 merger with Andeavor (formerly known as Tesoro Corp.). Andeavor/Tesoro had owned the refinery since 2001, when it acquired the facility from BP.

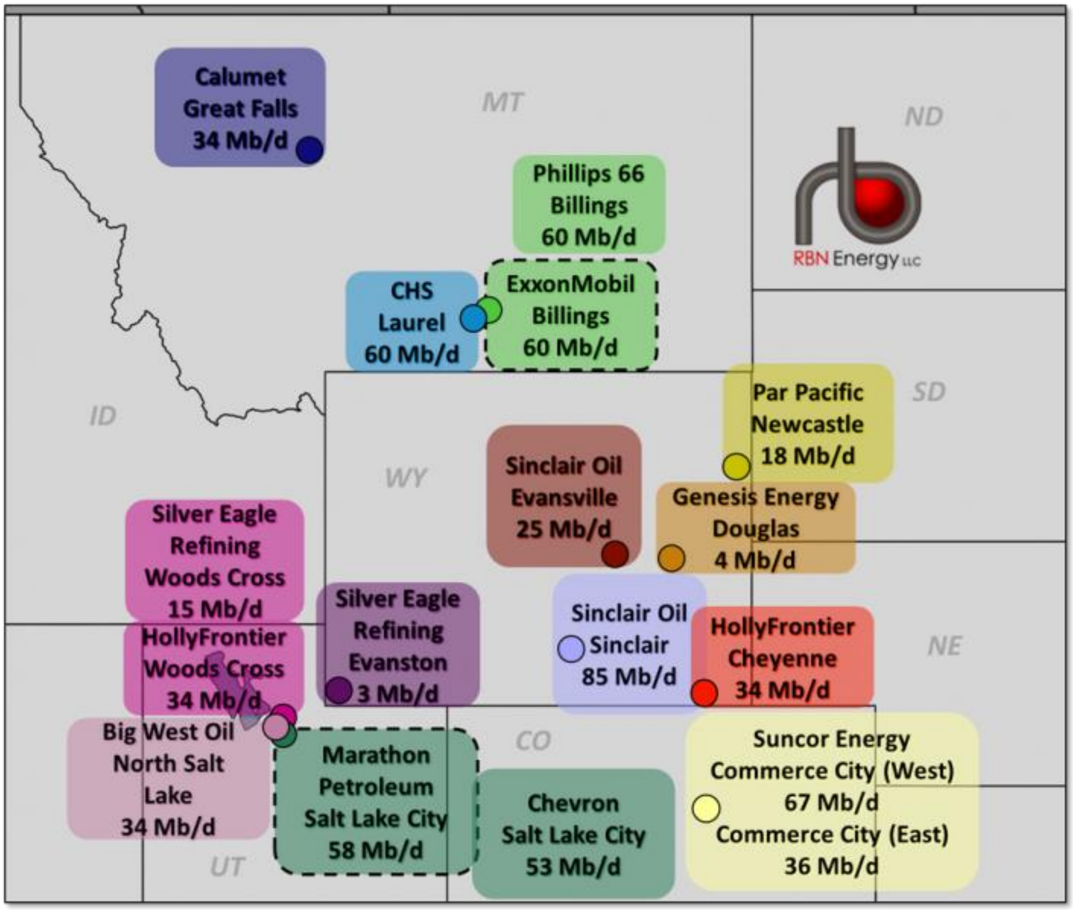

Figure 1. Rockies Refineries. Sources: EIA and RBN

The Rockies region (PADD 4) has a number of mostly smaller refineries but is an intriguing area because it offers lower-cost access to certain domestic and Canadian crude oils as well as an attractive market for refined products. On the crude side, many refineries in the Rockies have benefited from their proximity to light-oil production from areas such as the Bakken and the Denver-Julesburg (D-J) Basin. Also, heavy crude oil makes it into the region from Western Canada, and a specific type of waxy crude oil is produced in Utah. On the product-demand side, Rockies refineries mostly serve local market demand for gasoline and diesel. Refined products prices in the region can experience strong seasonal swings, with summer prices — set by the delivery of long-haul barrels from Texas and Kansas to meet demand — being very attractive. Unfortunately, the seasonal swings also mean that during the colder months, certain products (particularly gasoline) are seeking alternative markets such as Las Vegas for placement, and margins are generally lower.

Regarding the ExxonMobil and MPC refineries that are potentially available, the sellers' reasoning behind their possible sales would likely be strategic. ExxonMobil, as an integrated major oil company, has been focusing its domestic capital on the further integration of the company's Gulf Coast asset base. With a strong upstream development program in the Permian Basin and expansion projects including pipelines, refining and petrochemicals along the Gulf Coast, capital is being preferentially deployed in this area. While ExxonMobil's Billings refinery has some synergistic value with Imperial Oil's production in the Alberta oil sands, (ExxonMobil owns 69.6% of Imperial), Imperial has multiple outlets for its production due to, among other things, its ownership of a 191-Mb/d refinery in Edmonton, AB, and ExxonMobil's ownership of a 250-Mb/d refinery in Joliet, IL. MPC's offering of the Salt Lake City facility, in turn, is a little more surprising, but likely driven by a monetization opportunity after the company's long strategic review last year, which resulted in the decision to spin off its Speedway retail business later this year and potentially spin off MPLX, the midstream-focused master limited partnership that MPC formed in 2012.

On the **West Coast**, two refineries are potentially for sale:

- Shell was recently reported to be seeking a buyer for its 145-Mb/d Puget Sound refinery in Anacortes, WA (blue rectangle and dot in left map), just north of Seattle. Texaco built the refinery in the late 1950s, transferred a partial interest in it to Shell in the late 1990s as part of the two companies' Equilon JV, and then sold its stake to Shell in 2001 when Texaco merged with Chevron.
- Marathon Petroleum is also reportedly seeking a buyer for the 68-Mb/d refinery in Kenai, AK (pink rectangle and dot in map to right), which is about 60 miles southwest of Anchorage. This refinery was acquired by MPC in 2018 as part of the merger with Andeavor. Andeavor and its corporate predecessor, Tesoro Corp., owned and operated the facility since it was built in 1969.

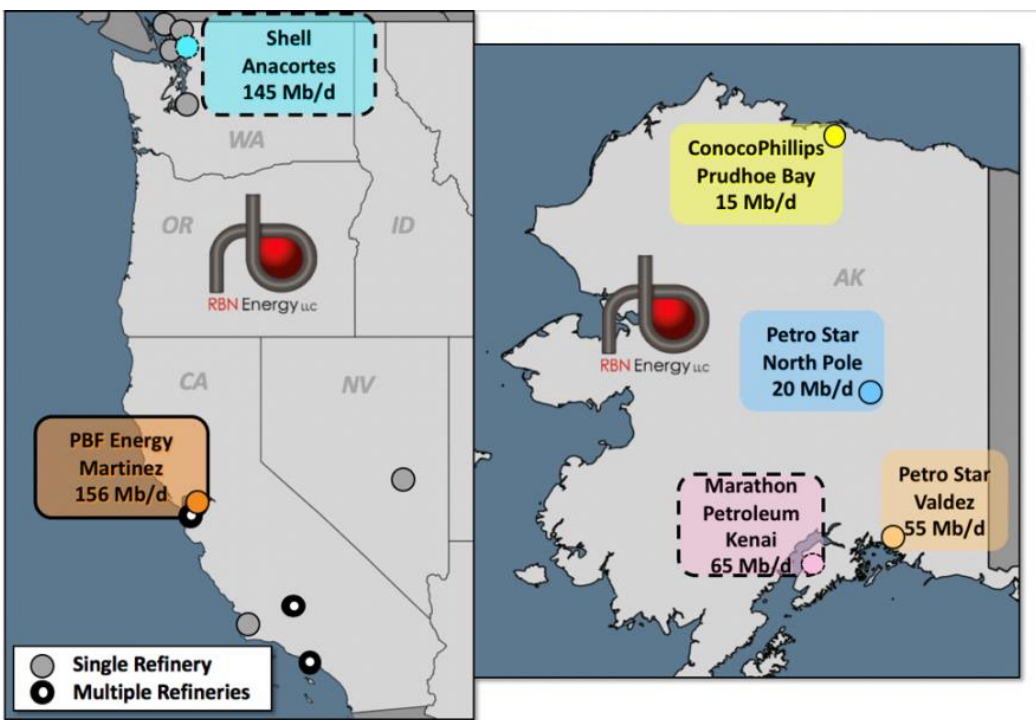

Figure 2. West Coast and Alaska Refineries. Sources: EIA and RBN

PADD 5 can be a tricky place to operate a refinery, but also a rewarding one at times. While there is local crude oil production in California and Alaska, intra-PADD pipeline movements are limited. Alaskan production can be delivered from the North Slope and Cook Inlet areas only as far as southern Alaska, before loading a ship. Additionally, California crude production is only pipeline-connected to California refineries. To complicate matters, both of these regions have experienced declining production for

years — quite the contrast from the shale production boom in other parts of the U.S. There is also limited pipeline access for the delivery of crude oil from other non-PADD 5 and Canadian sources to most of the refineries in the region. The Seattle market has the benefit of being connected to Western Canadian crude oil production via the Trans Mountain Pipeline, but capacity expansion plans on that pipeline have been stalled indefinitely. Therefore, the balance of the crude oil is supplied via ship from more distant markets and/or rail, depending on the refinery location. However, the West Coast also faces limited competition from other PADDs for refined products supply since there are only a few points of entry. For example, Kinder Morgan's pipeline out of West Texas will only get you as far as Phoenix; Holly Energy Partners' UNEV Pipeline runs from North Salt Lake City to Las Vegas; and MPC's Northwest Products system will get you from Salt Lake City to eastern Washington state. On balance, this leaves the West Coast as an importer of certain refined products. In addition, regulatory burdens in the form of the Low Carbon Fuel Standard (LCFS) rules in California and Oregon (and British Columbia), more stringent fuel quality requirements in California, and the challenge of securing permits and other approvals in the region only add to the trickiness of the market.

As for the individual refineries on the block in PADD 5, the motivations behind their possible sale may be a mix of corporate strategy and market sentiment. Shell appears to be making a slow, calculated withdrawal from the West Coast. A generation ago, Shell had its Equilon JV and assets strategically located in the region's major markets: Los Angeles, San Francisco and Seattle. Shell then sold its Southern California refining and retail business to Tesoro in 2007; it had previously sold another Southern California refinery to Unocal in 1991. The Martinez refinery (orange rectangle and dot in left map above), now owned by PBF Energy, had reportedly been on the market for quite a while before Shell found a buyer in PBF. If and when Shell sells its Anacortes refinery, it will have entirely left the refining business on the West Coast.

The news that MPC might be shopping its Alaska refinery is a bit puzzling since there appears to be some product marketing and intermediates integration between its Seattle and Alaska facilities. (MPC also owns a 119-Mb/d refinery in Anacortes, WA.) In addition, MPC recently expanded its footprint in Alaska with the acquisition of new storage terminals at Flint Hills Resources' former North Pole refinery. So the possible Kenai refinery sale may be just a monetization opportunity for the company that would allow it to focus MPC's operations on the Lower-48 business.

As we mentioned above, refineries go on the market for a variety of reasons and right now we happen to have a lot of them up for sale. (Notably, there are no assets on the Gulf Coast on the for-sale list.) With so many refineries on the market, why aren't more selling? Well, as we noted in Part 1 regarding the CVR assets, there are likely wide variances between the values placed on these assets by their sellers and potential buyers. This could be due to perceived risk of operation or perhaps varying outlooks. In addition, with most energy-sector companies reining in their spending and access to capital reportedly stalling in certain portions of the energy markets, there may be little wherewithal from certain potential buyers to make a big refinery buy. Finally, some of the refineries on the block — particularly the ones on the East Coast we discussed in Part 1 — have been bought and sold a few times in recent years and are still facing financial issues. Others on the list would certainly be premier assets, though that means buyers would have to pay a pretty penny for them.

Note: The article was authored by Amy Kalt of Baker & O'Brien and published on RBN Energy's Daily Energy Post on February 3, 2020.

"Shop Around" was written by Smokey Robinson and Berry Gordy. It would become the first million-selling record for The Miracles, and for Berry Gordy's Tamla/Motown Records.