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HEP - Q1 2016 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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Richard Voliva *Holly Energy Partners LP - VP and CFO*

Mark Plake *Holly Energy Partners LP - President*

CONFERENCE CALL PARTICIPANTS

Richard Roberts *Howard Weil Incorporated - Analyst*

Brian Kimball - *Analyst*

PRESENTATION

Operator

Welcome to the Holly Energy Partners first-quarter 2016 conference call and webcast.

(Operator Instructions)

Please note this conference is being recorded. It is now my pleasure to turn the floor over to Craig Biery. Craig, you may begin.

Craig Biery - *Holly Energy Partners LP - VP of IR*

Thanks, Nicole, and thanks to each of you for joining this afternoon. I am Craig Biery, Investor Relations for Holly Energy Partners, and welcome to our first-quarter 2016 earnings call. Joining us today are Mark Plake, President, and Rich Voliva, Vice President and CFO. This morning, we issued a press release announcing results for the quarter ending March 31, 2016. If you would like to a copy of today's press release, you may find one on our website at HollyEnergy.com.

Before Rich and Mark proceed with their remarks, please note the Safe Harbor disclosure statement in today's press release. In summary, it says statements made regarding management expectations, judgments, or predictions are forward-looking statements. The statements are intended to be covered under the Safe Harbor provisions of federal securities laws. There are many factors that could cause results to differ from expectations, including those noted in our SEC filings. Today's statements are not guarantees of future outcomes.

Also please note that information presented on today's call speaks only as of today May 3, 2016. Any time-sensitive information provided may no longer be accurate at the time of any webcast replay, or reading of the transcript.

Finally, today's call may include discussion of non-GAAP measures. Please see today's press release for reconciliations to GAAP financial measures. And with that, I'll turn the call over to Rich Voliva.

Richard Voliva - *Holly Energy Partners LP - VP and CFO*

Thank you, Craig, and thanks to each of you for joining us this afternoon. On April 22, Holly Energy Partners announced its 46th consecutive quarterly distribution increase to \$0.575 cents per unit, a 7% increase over the same period in 2015. This distribution represents an acceleration in year-over-year distribution growth and continued progress towards our 8% distribution growth rate target.

For the first quarter of 2016, HEP generated distributable cash flow of \$55.4 million, an increase of \$9.5 million or 21% over the same period last year. We maintained a very strong distribution coverage ratio of 1.2 times for the quarter. Net income attributable to HEP for the first quarter was \$43 million, compared to \$31.8 million for the same period in 2015. This increase was driven by higher volumes on our UNEV product pipeline as



well as contributions from our acquisition of the El Dorado processing units, and our 50% interests in both the Frontier and Osage pipeline joint ventures.

Operating expenditures in the period totaled \$27 million, including \$850,000 of OpEx reimbursed by HollyFrontier. Capital expenditures for the quarter were \$19 million, including approximately \$1.7 million of maintenance CapEx and \$1.1 million of reimbursable CapEx. Maintenance capital spend was slightly below guidance, primarily due to the timing of our scheduled projects. As contracts are finalized and the weather improves, we anticipate ramping up work, and reaching our annual maintenance capital target of \$10 million to \$15 million. In addition, we expect to spend \$50 million to \$60 million for expansion capital, excluding acquisitions.

As of March 31, 2015 HEP had approximately \$1.1 billion of total debt outstanding, comprised of approximately \$300 million of 6.5% notes due in 2020, and approximately \$765 million drawn on our credit facility. Interest expense was \$10.5 million in the first quarter, representing an increase of \$1.8 million over the same period in 2015.

In March, HEP amended its existing senior secured revolving credit facility from \$850 million to \$1.2 billion. The revolver matures in November 2018, and is available to fund capital expenditures, investments, acquisitions, distribution payments, working capital, and general corporate purposes. For the first quarter of 2016, we recognized \$6.6 million of deferred revenue from prior shortfalls billed to shippers. As of March 31, HEP carried \$2.8 million in deferred revenue on our balance sheet.

In the second quarter of 2016, we anticipate recognizing approximately \$300,000 of deferred revenue. Now, I'll turn the call over to Mark for a few comments.

Mark Plake - *Holly Energy Partners LP - President*

Thanks, Rich. We are very pleased with our strong first-quarter results, which demonstrate our ability to produce record distributable cash flow, despite the volatile commodity price environment. As Rich mentioned, our solid financial performance has enabled us to increase our distribution for the 46th consecutive quarter, and we continue to make progress towards our distribution growth target of 8%.

HEP's fee-based model, supported by long-term minimum volume commitments, provides us with a strong foundation for continued growth. In the first quarter of 2016, HEP achieved record UNEV volumes, increasing 44% versus the same period last year. Our outlook remains positive for UNEV's organic growth potential, now that the majority of Salt Lake City refineries are connected and HollyFrontier's 14,000 barrels per day Woods Cross refinery expansion is nearing completion.

HEP's overall transportation volume saw a 5% increase over the first quarter of 2015, and terminal tankage and loading rack volumes increased 27% over the same period last year. We continue to see stronger performance across all segments of our business, as we expand our core asset base.

During the first quarter of 2016, HEP successfully completed the acquisition of a 50% interest in Osage Pipeline Company. The Osage Pipeline Company operates a crude pipeline connecting both HFC's refinery in El Dorado, Kansas, and the CHS refinery in McPherson, Kansas to Cushing, Oklahoma. Additionally, HEP acquired crude oil tankage at HFC's Tulsa West refinery in March. Both transactions illustrate our ability to take advantage of the opportunity to purchase third-party assets located within our geography.

Going forward, we will continue to explore third-party acquisition opportunities, as well as evaluate the potential drop-down of assets related to HollyFrontier's Woods Cross Refinery expansion in the second half of 2016. We are now ready to turn the call over to Nicole for questions.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Richard Roberts.

Richard Roberts - *Howard Weil Incorporated - Analyst*

A couple of quick questions for you. You mentioned the Woods Cross expansion assets just now. I was curious if you could give us any status on what that project is as far as the ramp on the assets, and any better sense of timing, when those assets could be offered to HEP?

Richard Voliva - *Holly Energy Partners LP - VP and CFO*

I think what we can say Richard at this time is as I mentioned earlier the target is still to drop those down in the second half of 2016. And I think HFC is prepared to provide more details on their call tomorrow morning, so I believe we should probably defer to them. And the call tomorrow.

Richard Roberts - *Howard Weil Incorporated - Analyst*

Okay sure. We look forward to that. Can you give us any update or any sense on how capital market dependent, if at all that drop would be? Is HFC still willing to step in and provide some or all of the financing for that potentially?

Mark Plake - *Holly Energy Partners LP - President*

Sure, Richard. The short answer to that is yes, HFC is there if need be. I think it's pretty clear their preference is for cash, and so we're going to certainly seek to fund the acquisition of the drop down that way. Obviously, we've got tremendous flexibility with the revolver at the moment, and in the event we have a market dislocation, capital markets are not friendly, HFC is there.

Richard Roberts - *Howard Weil Incorporated - Analyst*

Got it. Okay let's see. At the analyst day, I think you highlighted some expected EBITDA uplift in the range of \$7 million or so, \$6 million or \$7 million, just related to some of the internal initiatives you are pursuing. Can you maybe give us an update on just how those are progressing, and just maybe where that is showing up in the financials, or maybe where we'll expect to see it show up in the financials later on this year.

Richard Voliva - *Holly Energy Partners LP - VP and CFO*

Sure. We're making good progress there. You're primarily going to see that in lower operating costs and a little, and basically you're talking about maintenance expenses primarily, and then just some straight cash operating expense as well.

Richard Roberts - *Howard Weil Incorporated - Analyst*

Okay, got it. And last one for me. Maybe just a bigger picture question on the HFC side, but do you have any sense of how much of the logistics assets that are serving HFC's refineries are owned by third parties, outside of HEP? And then adding onto that, if you think, or if you see there's much of any opportunity for you to be able to buy more of those assets? I guess similar to the Plains tanks that you bought this year?



Mark Plake - *Holly Energy Partners LP - President*

Sure. Short answer is there some big obvious ones, the Magellan product system, for example, that are probably safely in Magellan's hands. We do continue to see opportunities like the Plains tanks for example, and we're still working on some of those. I think we've talked, it's a fairly long list, not all of it will get done, but we do believe we'll continue to have some opportunities there going forward. It's hard for me to quantify for you, if you will.

Richard Roberts - *Howard Weil Incorporated - Analyst*

Sure. I appreciate that. Thanks.

Operator

(Operator Instructions)

[Brian Kimball].

Brian Kimball - *Analyst*

Just a couple quick ones. The deferred revenue number, \$2.8 million on the balance sheet I think you mentioned the \$300,000 number for the second quarter. Should we think about the remaining \$2.5 million just on a pro rata basis over the second half of the year?

Richard Voliva - *Holly Energy Partners LP - VP and CFO*

Yes. I think mostly towards the end of the year. As usual, most of that revolves around the UNEV pipeline. Additionally some of that we have one other customer of note who's got some deferred revenue that works on a calendar year basis. So I think most of that will probably show up in the fourth quarter.

Brian Kimball - *Analyst*

Great. And in speaking of UNEV, great growth year-over-year in those volumes. What continued growth are we looking for that asset specifically, as we go through the rest of the year?

Mark Plake - *Holly Energy Partners LP - President*

We're pretty optimistic there. Obviously the HollyFrontier Woods Cross expansion is coming online, so we're expecting to see the lion's share of those volumes, whether they come directly from HollyFrontier or from a third party. We're in the process of making our final connection to another refinery in the Salt Lake Valley, so we'll have everybody hooked up at that point. So we're, beyond HollyFrontier expansion, we're still optimistic to see more growth there.

Brian Kimball - *Analyst*

Where could that I guess end up from a utilization standpoint by the end of the year?

Mark Plake - *Holly Energy Partners LP - President*

That is hard to say, to be honest. I'm trying to think of a good way to frame this for you. Certainly, I think the best way to think about I think we've talked about this in our presentations before is, if you think about it this way, the HollyFrontier expansion should bring roughly 10,000 barrels a day incremental volume just by itself. Plus some other third parties. The tariffs that we have posted publicly you're talking about \$10 million to \$15 million of incremental revenue there just from that, in the next, call it, six months or so, so that will give you some flavor, Brian.

Brian Kimball - *Analyst*

That's very helpful. And then great coverage for the quarter, that 1.2 times clearly on the right path from a distribution growth standpoint. I don't know maybe the Street thinks 46 distributions in row are getting kind of boring. I'm assuming we should just keep on that steady path to get to the 8%. Any chance that if we do get some out performance from UNEV utilization, or the HFC drop goes quicker than expected, if we could see something north of 8%, or are we just comfortable at 8%, and keep trudging on down the right path?

Mark Plake - *Holly Energy Partners LP - President*

I think it's a possibility. What we would say is we're very comfortable with the 8% number. To be honest, some of this is going to depend on just how much of this third-party business we can get done in the next 6 to 12 months, call it. That's a little hard for me to handicap. But certainly we feel comfortable with 8% number.

Brian Kimball - *Analyst*

Great. That's good color. I appreciate it.

Operator

If there are no further questions, I will turn the floor back over to Craig for his closing remarks.

Craig Biery - *Holly Energy Partners LP - VP of IR*

Thanks again for joining the call today. If you have any follow-up questions please feel free to reach out to investor relations. Otherwise we look forward to sharing our second-quarter results with you in August. Thank you.

Operator

This concludes the conference call you may now disconnect. Thank you for joining and have a good day.



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