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HEP - Q3 2016 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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Rich Voliva *Holly Energy Partners, L.P. - SVP, CFO*

Mark Plake *Holly Energy Partners, L.P. - President*

PRESENTATION

Operator

Welcome to Holly Energy Partners third quarter 2016 conference call and web cast. At this time all participants have been placed in a listen-only mode. The floor will be open for questions following the presentation. (Operator Instructions). This conference is being recorded. It is now my pleasure to turn the floor over to Craig Biery. You may begin.

Craig Biery - *Holly Energy Partners, L.P. - IR*

Thanks, Nicole. Thanks to each of you for joining this afternoon. I am Craig Biery, Investor Relations for Holly Energy Partners, and welcome to our third quarter 2016 earnings call. Joining us today are Mark Plake, President and Richard Voliva, Senior Vice President and Chief Financial Officer. This morning we issued a press release announcing results for the quarter ending September 30, 2016. If you would like 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 expectation, judgment or predictions are forward-looking statements. These statements are intended to be covered under the Safe Harbor provision of Federal Securities law.

There are many factors that can cause results to differ from expectations including those noted if 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, November 2, 2016. Any time sensitive information provided may no longer be accurate at the time of any web cast 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 will turn the call over to Rich Voliva.

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

Thank you, Craig and thanks to each of you for joining the call this afternoon.

On October 21, 2016 Holly Energy Partners increased its quarterly distribution to $0.595 per unit. Distribution will be paid on November 10, 2016 to unit holders on record as of October 31, 2016 and represent year-over-year distribution growth of 7.2%. We continue to progress towards our target of 8% distribution growth.

Net income attributable to HEP for the third quarter was $34.8 million compared to $34.3 million for the same period in 2015. The increase was driven by recent acquisitions including the El Dorado processing unit, Tulsa Crude Tanks, and joint venture interests in the Osage and Cheyenne Pipeline. For the third quarter distribution coverage fell to an artificially low of 0.93 times due to timing of financing for the Woods Cross drop down. In short, we felt the full burden of the necessary financing expenses during the quarter, but did not see any of the cash flow from the drop down.

As these earnings come through in fourth quarter we anticipate our coverage ratio will revert to the right level, to 1 to 1.2 times. Specifically in the third quarter HEP generated distributable cash flow of $49.3 million compared to $49.7 million in the same period last year. This decrease was driven primarily by the increase interest expense associated with our July debt issuance.

During the third quarter we raised over $8 million of common equity for our continuous offering, our ATM program. And in October HEP issued just over $100 million of common equity for the private placement of Tortoise Capital Advisors. We do not anticipate further equity financing needs for the remainder of 2016.

Operating expenses in the period totaled $28 million and depreciation and amortization totaled $15.5 million. Going forward we expect the Wood Cross drop down will add an incremental $6 million of OpEx and $3 million of depreciation per quarter. Our capital expenditures for the third quarter were over $15 million including approximately $4 million in maintenance CapEx and $4 million of reimbursable CapEx.

We expect to spend between $60 million and $65 million of total capital excluding acquisitions for the year. This includes $10 million to $15 million of maintenance CapEx and $10 million to $15 million of reimbursable CapEx.

As of September 30, 2016 HEP had approximately $1.1 billion of total debt out standing comprised of $400 million of 6% notes due in 2024, $300 million at 6.5% notes due in 2020 and approximately $370 million drawn on our credit facility. For the third quarter 2016 we recognize roughly $240,000 in deferred revenue from prior short falls billed to shippers. As of September 30, 2016 HEP carried $6.7 million of deferred revenue on our balance sheet. And in the fourth quarter of 2016 we anticipate recognizing approximately $250,000 of deferred revenue.

With that, I will turn the call over to Mark for a few comments.

Mark Plake - *Holly Energy Partners, L.P. - President*

Thanks, Rich. Good afternoon, everyone. And, Happy Birthday, Craig.

We are pleased with our solid financial performance in the quarter. As Rich mentioned we announced a $0.01 increase for our quarterly distribution for the third quarter representing the 48th consecutive distribution increase since our IPO in 2004. This increase demonstration our continued commitment to achieving a target 8% distribution growth rate. Through its long history of building, maintaining and operating mid-stream assets HEP has created a solid business foundation.

Our positive growth outlook is reinforced by solid fee based model coupled with minimum value commitment supporting over 80% of our revenue. I would like to highlight the previously announced acquisition by HEP of certain Woods Cross refinery access on October 1, 2016. These access include the newly constructed crude unit, fluid catalytic cracking unit and polymerization unit.

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

HFC and HEP entered into a 15 year tolling agreement for each respective unit containing minimum quarterly throughput commitments from HFC. These new units are expected to generate annual EBITDA of approximately $32 million in 2017 representing a transaction multiple of 8.5 times. This acquisition not only provides HEP with significant earnings potential, but demonstrates the strong relationship between HEP and HollyFrontier.

We expect 2017 will bring external opportunities for growth in the midstream space. Given the quality of our assets, our talented employees and a financially strong and supporting partner in HollyFrontier we believe HEP is in a position to participate. Over the past 12 months we have had great success having stakes in the Frontier, Osage and Cheyenne Crude pipeline, acquiring additional storage assets in Tulsa as well as adding the Woods Cross refinery assets we just discussed.

In addition to both on acquisitions and drop downs from HFC, we plan to evaluate larger external opportunities with a long-term goal of reaching $500 million in EBITDA.

We are now ready to turn the call over to Nicole for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Thank you. Your first question comes from the line of Brian. Your line is open.

Unidentified Participant - - *Analyst*

Maybe we can start where you just left off, larger external opportunities. In this current market given volatility in pretty much every commodity as you look out into 2017 and think about your positioning in it, what pieces of the market, what types of assets excite you the most, either opportunistically, or strategically or a combination of both, as well?

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

Sure. Generally speaking we view our biggest and best opportunities are probably the geographies where we currently operate, I'll call it the Rockies, and mid continents and the Permian basin, Delaware within the Permian basin. We have got a great staff of operators with experience across the liquids gas storage pipeline. You name it. We have a great team and we've got a lot of value in those geographies where we have very clear operating synergy's. As Mark said, we are optimistic for next year.

Unidentified Participant - - *Analyst*

Any limitations as you see them today from a capital market standpoint, or is it just finding the right opportunity?

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

We feel we have had some pretty good success with the capital markets this year. We feel like they are open to us. To your point it is more of an exercise of finding those opportunities and finding the ones that are really going to make us and our stakeholders the returns they want to see.

Unidentified Participant - - *Analyst*

Great. And then, Rich, you gave us some numbers on Woods Cross benefit. We have the EBITDA number. You gave us the OpEx and the DNA number moving forward. As those assets start to contribute this quarter, how should we think about it from a refining standpoint? I know you have taken out a lot of the variability due to the way the contract is structured between you guys and HFC. Are there any points you want to clarify as to how to best think of any potential moving pieces on a quarter to quarter basis? Or, are you taking the stance that in general it is going to be a relatively consistent $8 million give or take a little bit quarter every quarter with really only out liars being extreme circumstances as to refining (inaudible).

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

Brian, to your point, we are expecting this to be a pretty consistent pipeline like, if you will, revenue stream. And earning stream going forward. The contracts are set up very much like pipeline contracts if the units are available to run, the minimum volume commitments are enforced. The obvious exception here will be turn around periods. Again, just like a pipeline, if we have maintenance to take, those minimums are not enforced. Obviously (inaudible) a typical three to five-year turn around cycle. We've got several years before that will be something to think about.

Unidentified Participant - - *Analyst*

Great and last one from me, you said the deferred number at Q3 was 6.7, I think I caught this right, you are expecting to recognize just $250,000 in Q4, is that right?

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

Yes. Oh, I'm sorry. It looks like my number was wrong. It will be more like $2.5 million. I missed a decimal place.

Unidentified Participant - - *Analyst*

Yes. That was hopefully was I was getting at. You recognize how much during Q3?

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

It is about a quarter million dollars.

Unidentified Participant - - *Analyst*

Okay. The quarter million was in Q3, that was down quarter on quarter and we should be back up to a more consistent 2.5 million.

Rich Voliva - *Holly Energy Partners, L.P. - SVP, CFO*

Generally speaking the fourth and the first quarter is when we tend to recognize them most and that's related to two specific assets. One, our contractual arrangements with (inaudible), and then two, the UNEV (inaudible).

Unidentified Participant - - *Analyst*

Great. That's helpful, Rich. Appreciate it.

Operator

(Operator Instructions). There are no further questions at this time. I will turn the call back over to Craig for closing remarks.

Craig Biery - *Holly Energy Partners, L.P. - IR*

Thanks again for joining the call today. If you have any follow-up questions please reach out to Investor Relations. Otherwise, we look forward to sharing our fourth quarter results with you in February. Thank you.

Operator

This concludes this call. You may disconnect.
