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HEP - Q1 2019 Holly Energy Partners LP Earnings Call

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Joseph Robert Martoglio *JP Morgan Chase & Co, Research Division - Analyst*

Justin Scott Jenkins *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Spiro Michael Dounis *Crédit Suisse AG, Research Division - Director*

PRESENTATION

Operator

Welcome to the Holly Energy Partners First Quarter 2019 Conference Call and Webcast. (Operator Instructions) Please note that this conference is being recorded. It is now my pleasure to turn the floor over to Jared Harding. Jared, you may begin.

Jared Harding - *Holly Energy Partners, L.P. - IR Officer*

Thanks, Sam, and thank you all for joining our first quarter 2019 earnings call. I'm Jared Harding, Investor Relations Manager for Holly Energy Partners. Joining us today are George Damiris, President and CEO; and Rich Voliva, Executive Vice President and CFO.

This morning, we issued a press release announcing results for the quarter ending March 31, 2019. If you'd like a copy of today's press release, you may find one on our website at hollyenergy.com. Before George and Rich 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. These 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 the call speaks only as of today, May 1, 2019. 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 George.

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

Thanks, Jared, and thanks to each of you for joining the call this afternoon. HEP delivered solid first quarter results and announced the distribution of \$0.67 per unit, marking our 58th consecutive distribution increase since our IPO in 2004 and a 2% increase over the same period last year.

Overall pipeline volumes increased 5% compared to the first quarter of 2018, highlighted by record volumes on our crude gathering systems of 157,000 barrels per day.



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We also experienced strong third-party spot shipments on the UNEV Pipeline as the arbitrage between Salt Lake City and Las Vegas was open for the majority of the quarter and continues through the month of April. The Orla truck rack came online during the first quarter and has allowed HollyFrontier to meet the growing demand for distillate in the Permian Basin. For the rest of 2019, our focus remains on safe, reliable operations and organic growth projects that leverage our relationship with HollyFrontier to take advantage of commercial opportunities that add value to both companies. With that, I'll turn the call over to Rich.

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Thank you, George. Net income attributable to HEP for the first quarter was \$51 million compared to \$46 million in the first quarter of 2018. This increase was driven by stronger crude pipeline volumes, higher refinery reprocessing unit revenue and contractual tariff escalators, all partially offset by higher interest expense.

HEP generated distributable cash flow of \$71 million in the quarter, a 2% increase compared to the same period last year. Our distribution coverage ratio was 1.03x for the quarter. We expect seasonal factors to drive coverage under 1x in the second quarter, and we continue to expect an average coverage ratio of 1x for the full year of 2019.

The capital expenditures for the quarter were approximately \$11 million, including \$1 million of maintenance Capex and \$1 million of capital reimbursed by HollyFrontier.

For 2019, we expect to spend approximately \$7 million and \$10 million of maintenance Capex and \$20 million to \$25 million of expansion capital, excluding reimbursable Capex. As of March 31, HEP had \$1.4 billion of total debt outstanding, resulting in a debt-to-EBITDA ratio of 4.1x. Our modest leverage, coupled with a strong liquidity position of almost \$500 million, allows us flexibility in financing future growth opportunities.

Now I'll turn the call over to Sam for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from the line of Justin Jenkins from Raymond James.

Justin Scott Jenkins - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

George, you mentioned some pretty good momentum in the Permian with the volumes. I guess first question is how much more can the existing asset base on the crude gathering side ramp from here? And maybe any other developments on the opportunity sets to expand and bolt on in that system here?

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

Yes, it's hard to give you a specific number on expansion potential. It's very system-dependent. The majority of our systems are running full out, but there are systems that have capacity on them. So overall, we're very pleased with what we're seeing in the Permian, especially in the New Mexico Permian that we see the most through our -- around our Artesia refinery. And we continue to see production increases and producers' interest in getting that crude oil moved from their wells to either our refinery or to a central sales point.

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Justin Scott Jenkins - *Raymond James & Associates, Inc., Research Division - Senior Research Associate*

Okay. That's helpful. And one of your peers recently had some success with the drop-down transaction. I know this is maybe more of a question for the HFC call tomorrow but any thoughts in terms of any assets left that could possibly find its way from HFC down to HEP or maybe even outlook on third-party type of M&A that you might be looking at here?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Yes, Justin, it's Rich. At this point, it's really certainly, I think we've been pretty clear the traditional type of logistics assets have all been dropped to HEP. And then you're into HFC's financing needs and optimizing those. And really right now, there's not a lot that requires financing. So we would not anticipate any drop-down transactions in the near future. Third-party M&A, look, we continue to look, but I think we've seen the same thing several of our peers have, where the third-party market, particularly driven by the private equity side, is completely dislocated, which is what -- from what you can finance profitably in the public markets. So we don't really expect to see very much there at the moment.

Operator

And our next question comes from the line of Jeremy Tonet from JPMorgan.

Joseph Robert Martoglio - *JP Morgan Chase & Co, Research Division - Analyst*

This is Joe on for Jeremy. You mentioned organic growth potential in the PR, and I just wanted to see is there anything we should read into with, are you seeing more opportunities there? And could you give any specifics on whether there's some projects on that side?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Joe, we're expecting to spend \$20 million to \$25 million of organic growth capital this year. It's -- there's probably no single project to call out similar to Orla last year of real size. And we continue to find plenty of small things to do in and around the system all over the place, and that's driving those dollars this year.

Joseph Robert Martoglio - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. That's helpful. And then you also mentioned arbitrage opportunities between Salt Lake and Las Vegas for the first quarter. Are you expecting that to persist throughout the year and help you guys out for the rest of the year as well?

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

Well, as you know typically, it's a very seasonal play during the second and third quarter. Salt Lake is typically stronger than the first and fourth quarter. So the arbitrage to get barrels from Salt Lake to Vegas is really more of a first and fourth quarter phenomenon. This year, there have been a number of refinery issues on the West Coast, which typically supplies a lot of volume to the Vegas market. And with those operating issues, supply from the west is less than typical. So it's opening up the arbitrage more than typical even -- coming into the second quarter here.

Operator

And our next question comes from the line of Spiro Dounis from Crédit Suisse.



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Spiro Michael Dounis - *Crédit Suisse AG, Research Division - Director*

Rich and George, just want to follow up on Justin's question around drop-downs or maybe skew more towards how they actually finance it. I think one of the interesting things we saw was the fact there was a direct offering of pretty decent size, which I guess shouldn't surprise us entirely since the capital markets I think are largely still close to some degree. Just curious on top of the credit facility that you guys mentioned, in terms of financing any growth, are you getting that same feedback directly from investors that they're, sort of -- they're willing and ready to maybe come in directly on a deal if you guys identify something?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Yes, Spiro, so I think we've had success frankly doing similar things with -- in terms of direct placements with shareholders of ours historically, particularly about a year ago, a little more than that. So we do believe that market is there. It's very expensive. So it's not particularly attractive at this moment. But yes, we would agree that there is some appetite in the market for those kind of things.

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

For the right opportunity, yes?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Yes, absolutely.

Spiro Michael Dounis - *Crédit Suisse AG, Research Division - Director*

Sure, sure, makes sense. Second one, just on the overall structure. And I think it's -- in terms of the MLP, I know it's something you're sort of always evaluating. And just curious -- there's been some movement over the last few months, I guess. There's been some M&A or potential M&A in the space, and just curious if you've been sort of leaning any one way or the other in terms of how you think about the MLP structure overall?

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

No. I think Rich touched on it earlier in the call that there's a wide differential between the public and private equity markets in this space. That's influencing the valuation of certain assets and certain public equities. But overall, we are comfortable with where we are with HEP as part of the larger HFC portfolio of companies. We think we're getting good value for having it as a separate entity, and we don't foresee changing anything in the near future.

Spiro Michael Dounis - *Crédit Suisse AG, Research Division - Director*

Got it. Makes sense. Last one for me. Last 2 quarters have been a bit noisy with some refinery downtime and seasonal turnarounds. Just curious as you look through to the second quarter here, was all that sort of ring-fenced in the past now and would you expect, for the most part, a pretty normal second quarter?

George J. Damiris - *Holly Energy Partners, L.P. - President, CEO & Director of Holly Logistic Services LLC*

Yes, we do. We don't have any major turnarounds at HollyFrontier till the fall, September, October timeframe. So we don't see anything coming up in the next few quarters.

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Operator

And your next question comes from the line of Chris Sighinolfi from Jefferies.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

I just have a question, Rich, I think it's probably for you regarding HEP's contract arrangement with Delek. I was reading back through your 10-K, and it looks like they let some of the capacity leased agreement go at the end of last year when they matured. I believe that was on Orla or El Paso. Those appear modest, but they have bigger contracts that come for maturity, I believe, in 2020 and 2022. So -- but just curious -- I know it's probably a bit premature, but what conversations you've had with them, if any, about renewal and what your expectations are at this point?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Yes. Chris, we have good relationship with Delek. They're good a customer of ours, and we continue to talk to them about this. To your point, it's a little early in this process, but the lines of communications are definitely open here. We're expecting a good resolution at the end.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Was there something they cited about the desire -- or the decision they made at the end of last year with regards to the capacity that they let go? Or it's just maybe different than what's in the future or...

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

No. I mean I'd defer to them for comments on their business, but best to our understanding was obviously Delek had purchased their refinery from Alon to doing things slightly differently than historically. So they had some slightly different needs, but really, it's probably a better question for them than for us.

Christopher Paul Sighinolfi - *Jefferies LLC, Research Division - Senior Equity Research Analyst, Master Limited Partnerships*

Okay. Fair enough. And then separately, there was an earlier question on drop-downs. I think you've mentioned everything that sort of is down in -- or could be down is down. But wondering about, as HFC has brought on Sonneborn and continues to make additional investments in the lubricants space, I don't even know about the qualifying nature of anything that might be there and be suitable for HEP or not, but figured I'd touch on it just given the significant investments in that vertical upstairs. So is there anything that could come down?

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - Executive VP & CFO of Holly Logistic Services LLC*

Yes, so we'll -- yes, Chris, there probably is. We haven't given the cost of capital issues we've seen in MLP market. We haven't spent a lot of time looking at this, but we would expect there are some assets that will qualify, but it hasn't made sense for us to push down this avenue yet.

Operator

(Operator Instructions) If there are no further questions, I will turn the floor back over to Jared for any closing remarks.



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Jared Harding - *Holly Energy Partners, L.P. - IR Officer*

Thanks again for joining the call today. Feel free to reach out to Investor Relations if you have any questions.

Operator

This concludes today's conference call. You may now disconnect. Thank you for joining, and have a great day.

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