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HEP - Q3 2017 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

Operator

Welcome to Holly Energy Partners Third Quarter 2017 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

Thanks, Barbara, and thank you all for joining our third quarter 2017 earnings call. I am Jared Harding with Investor Relations for Holly Energy Partners. Joining us today are George Damiris, President and CEO; and Rich Voliva, Senior Vice President and CFO.

This morning, we issued a press release announcing results for the quarter ending September 30, 2017. 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 today's call speaks only as of today, October 31, 2017. 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. - CEO, President & Director of Holly Logistic Svcs LLC*

Thanks, Jared, and thanks to each of you for joining the call this afternoon.

On October 26, Holly Energy Partners increased its quarterly distribution by $0.0125 to $0.645 per unit. The distribution will be paid on November 14 to unitholders on record as of November 6. This distribution represents year-over-year distribution growth of 8.4% and marks the 52nd consecutive distribution increase since our IPO in 2004.

During the quarter, we announced the acquisition of the remaining interest in the Salt Lake City and Frontier Pipeline, which supply Canadian and Rocky Mountain Crude Oil to refineries in the Salt Lake City area. We have received HSR approval, and the transaction is closing today. We anticipate that the new pipeline interests will generate a combined annual EBITDA of $23 million in the first year, and we expect improvement from there.

I'd also like to highlight the IDRs Simplification agreement with HFC. It was previously announced on October 19. The transaction eliminates the IDRs held by HFC and converts the 2% GP interest in HEP into a noneconomic interest. In exchange, HEP will issue 37.25 million common units to HFC. Additionally, HFC has agreed to waive $2.5 million of LP cash distributions for 12 consecutive quarters beginning with the first distribution for which the newly issued units are eligible. On closing, HFC will own approximately 59% of the outstanding HEP units, with the market value of approximately $2 billion. This transaction will also close today. The IDRs Simplification significantly improved HEP's cost of capital and better equips HEP to pursue both organic projects and third-party acquisition.

Going forward, HEP is positioned to achieve greater value creation, and the elimination of the IDRs should result in accelerated growth and improved valuation levels over time.

And with that, I'll turn the call over to Rich.

Richard Lawrence Voliva - *Holly Energy Partners, L.P. - CFO of Holly Logistic Services, L.L.C and Senior VP of Holly Logistic Services, L.L.C*

Thank you, George. Net income attributable to HEP for the third quarter was $42.1 million, an increase of 21% compared to the same period last year. This increase was driven by the Woods Cross refinery processing units that were dropped down during the fourth quarter of 2016.

The third quarter HEP generated distributable cash flow of $59.2 million compared to $49.3 million for the same period in 2016. Pro forma for the impact of the IDRs Simplification, distribution coverage was 0.94x for the quarter. Coverage was adversely affected by a onetime $2.9 million negative adjustment related to overbilling on a crude-gathering contract with HollyFrontier. Without this adjustment, coverage would have been 0.99x.

Operating expenses in the period totaled $36 million, depreciation and amortization totaled $19 million. Our capital expenditures for the quarter were approximately $10 million, including $3 million in maintenance CapEx and $1 million of reimbursable CapEx. We expect to spend between $40 million and $50 million of total capital, excluding acquisitions for the year. This number does include $10 million to $50 million of maintenance CapEx and $5 million to $10 million of reimbursable CapEx.

As of September 30, HEP had approximately $1.2 billion of total debt outstanding. In July, HEP's credit agreement was amended, increasing the size of our facility from $1.2 billion to $1.4 billion, and extending the maturity to July of 2022.

In September, we also completed a tack-on offering of $100 million to our 6% senior notes due in 2024. Our increased liquidity position will help fund the SLC and Frontier Pipeline acquisitions George previously mentioned.

In the third quarter of 2017, we recognized roughly $750,000 of deferred revenue from prior shortfalls billed to shippers. As of September 30, HEP carried a total of $14.8 million in deferred revenue on our balance sheet. And in the fourth quarter of 2017, we anticipate recognizing approximately $4.8 million of deferred revenue.

With that, I'll turn the call over to Barbara for any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Justin Jenkins of Raymond James.

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

Congrats on getting both the deals done here today. I guess I'll start on the SLC and tier pipelines. George, you have maybe alluded to this in your prepared remarks on potential improvements. But maybe any higher-level thoughts on the opportunity for synergies or increasing volumes as you gain full ownership?

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

Very high level, there is expansion capability on these pipelines. And with the declining production in the local areas, especially in the wax crude, we think there's potential to bring more crudes from Canada and from Casper down to the Salt Lake City refineries.

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

Perfect. That's helpful. And then I guess thinking about the forward outlook here, refining margins are strong currently and the view into 2018 appears pretty good. I guess, any higher-level thoughts on how a better refining outlook might translate into more throughput across HEP's overall system here?

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

Well, I think you just said it. I think that's exactly what it translates into. We think all our refineries are well positioned to have healthy margins and healthy volumes. With the caveat that we do have some planned turnarounds in Tulsa in February and in El Dorado in March that we need to take in account.

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

Perfect. And then last one for me I guess. It seems like the market's rewarding more, I guess, self-funding and higher coverage at least recently here. Any thoughts on how the IDR volumes changes your views towards the balance of distribution growth versus higher distribution coverage? And I'll leave it there.

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

Yes, Justin, rules in general, our intent is to grow the -- to pay distributions with a coverage ratio of greater than 1. Obviously, this quarter had a one-off, we all saw it. And to be fair, the IDRs Simplification was going to be somewhat dilutive from a coverage perspective in the first year here, so we've got that to chew through. But in a long run, we'd expect to continue to grow the distribution with a coverage ratio of greater than 1.

Operator

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

Jared Harding

Thanks, again, for joining the call today. If you have any follow-up questions, please reach out to Investor Relations.

Operator

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