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HEP - Q4 2017 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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Corey Benjamin Goldman *Jefferies LLC, Research Division - Equity Analyst*

Theresa Chen *Barclays PLC, Research Division - Research Analyst*

PRESENTATION

Operator

Welcome to Holly Energy Partners Fourth Quarter 2017 Conference Call and Webcast. (Operator Instructions) Please note 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, Cheryl, and thank you all for joining our fourth 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, Executive Vice President and CFO.

This morning we issued a press release announcing results for the quarter ending December 31, 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, February 20, 2018. 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. HEP wrapped up 2017 with strong fourth quarter results, and we continued our successful track record of distribution growth with the 53rd consecutive increase since our IPO in 2004. This distribution was $0.65 per unit, representing a 7% increase over the same period of 2016.

During the quarter, we completed the acquisition of the remaining interest in the Salt Lake City and Frontier pipelines, which supply Canadian and Rocky Mountain crudes to refineries in the Salt Lake City area. Overall, pipeline volumes increased 30% compared to the fourth quarter of 2016, primarily driven by additional crude volumes from this acquisition. Further, we saw higher refined product shipment due to higher production in HollyFrontier's Navajo refinery and increased volumes on the UNEV Pipeline.

We also completed the IDR simplification agreement with HollyFrontier in October. The IDR Simplification provides HEP with a more competitive cost of capital, better equipping us to pursue both organic projects and third-party acquisitions. Looking ahead in 2018, we expect to increase the quarterly distribution by $0.005 per unit per quarter, resulting in an annual distribution growth rate of 4%. Distribution coverage is expected to average approximately 1 for the full year.

We will continue to leverage our existing footprint to grow organically, especially in the Permian. As we mentioned at Analyst Day, we have a debottleneck of the Malaga pipeline systems and expansion of the Salt Lake City and Frontier pipelines scheduled this year.

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*

Thanks, George. Net income attributable to HEP for the fourth quarter was $86 million compared to $41 million in the fourth quarter of 2016. This increase was primarily driven by the acquisition of the remaining interest in the SLC and Frontier Pipelines and includes a onetime $36 million gain related to the remeasurement of HEP's preexisting interest in these lines at fair value.

HEP generated distributable cash flow of $66 million in the quarter, a 12% increase compared to the same period of 2016. We had a distribution coverage ratio of 1.03x for the quarter and 1.00x for the full year of 2017. As George mentioned, we expect to average a coverage ratio of 1.0x for 2018, with higher coverage ratios in the second half of the year due to contractual tariff escalators.

Operating expenses in the period totaled $35 million. Depreciation and amortization totaled $22 million. Our G&A expense of $5.5 million includes roughly $2.5 million of onetime consulting fees related to the IDR Simplification.

Our capital expenditures for the quarter were approximately $17 million, including $1.4 million of maintenance CapEx and $2 million of reimbursable CapEx. In 2018, we expect to spend $7 million to $10 million for maintenance CapEx and $30 million to $40 million for expansion capital excluding acquisitions and CapEx reimbursed by HollyFrontier.

For the fourth quarter, we recognized $6 million of deferred revenue from prior shortfalls billed to shippers. At the end of the year, HEP carried roughly $4 million of shortfalls in deferred revenue on our balance sheet, and we anticipate recognizing approximately $3 million of this deferred revenue in the first quarter of 2018.

As of December 31, HEP had $1.5 billion in total debt outstanding, resulting in year-end net-debt-to-EBITDA ratio of 4.4x. Based on the equity markets' weakness during the fourth quarter, we elected to temporarily finance all of the SLC and Frontier acquisitions via our revolving credit facility. In February of 2018, we issued a $110 million of limited partner equity through a private placement, with the proceeds used to repay a portion of the debt associated with the Frontier and SLC acquisitions. Following this issuance, our liquidity was over $500 million and our pro forma debt to trailing EBITDA stood at approximately 4.1x. We expect to reach the targeted debt-to-EBITDA ratio of 4x by year-end 2018. This strong liquidity position and ability to access the capital markets allow us full flexibility in financing future growth.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question is from Theresa Chen, Barclays.

Theresa Chen - *Barclays PLC, Research Division - Research Analyst*

I wanted to first ask about the pipeline volume strength. You saw some nice quarter-over-quarter increases even outside of the acquisition of the incremental interest in SLC and Frontier. When we look at the first quarter and the rest of the year, can you talk about how much of that ex-acquisition volume bump was sustainable -- or is sustainable? And maybe breaking out how much was owed to UNEV seasonal strength versus how much was due to Navajo's increased production and so on.

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*

Theresa, it's Rich. So I'd say, look, directionally you're on the right themes here, which is SLC and Frontier drove the major piece of it. We had continued strong production at Navajo, and going into 2018, there's really no reason to think that's going to change. And UNEV had a seasonally strong quarter, particularly in the month of December, when the arb opened up between Las Vegas and Salt Lake City itself. We're continuing to see that into the first quarter. We expect typical seasonality on UNEV this year based on what we know today.

Theresa Chen - *Barclays PLC, Research Division - Research Analyst*

Got it. And in terms of the expansion later on this year for SLC and Frontier, can you talk about the economics there?

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

Yes. Theresa, I don't think we're going to go into too much detail on the economics there. I think, as you know, organic growth is done at a lower EBITDA multiple than acquisitions, but we're not going to give a specific guidance on the exact multiples of our organic projects.

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*

If I could just say, Theresa, it's not a huge project. We have it within that $30 million to $40 million of capital. So it's a good payout, to George's point, but it's not enormous in size.

Theresa Chen - *Barclays PLC, Research Division - Research Analyst*

Understood. And lastly, just thinking about the big picture. Are there other areas or geographies of acquisition and growth you think would be obvious for the partnership?

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

Yes. I don't think there's anything that falls into the obvious category, Theresa. I mean, we've got some good diversity across both HEP and HFC from which to grow. We're exposed to most, if not all, the major crude oil basins in the U.S., and then we have a product distribution associated with the refineries as well.

Operator

(Operator Instructions) Our next question comes from Corey Goldman, Jefferies.

Corey Benjamin Goldman - *Jefferies LLC, Research Division - Equity Analyst*

A quick one just on equity, Rich. Is -- can you give us an expectation just what we should think about for what the strategy is for financing the rest to get to that 4x? Is it just on the ATM?

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*

Yes. Corey, we're going to -- there'll be selective use of the ATM for the balance of the year. Realistically, it's not a terribly large number. Between EBITDA growth in the business, primarily driven by contractual escalators, and what we expect to do in the ATM, we'll get to that leverage ratio presumably this year

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Corey Benjamin Goldman - *Jefferies LLC, Research Division - Equity Analyst*

Got you. And that's actually a good segue into just the follow-up question. The escalators, can you comment what's in your guidance to get to the 1x on average? Like what's the PPI that you guys are using?

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*

We had used roughly -- we had made a little bit of an estimation on the end of the year. Frankly, it may be a little bit conservative, but we are running, using the POS data, roughly 3%.

Operator

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

Jared Harding

Thanks, Cheryl, and thanks again for everyone joining the call today. If you have any follow-ups, don't hesitate to reach out to Investor Relations. Thanks.

Operator

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