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HEP - Q3 2018 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator

Good afternoon, and welcome to the Holly Energy Partners Third Quarter 2018 Conference Call and Webcast. (Operator Instructions) Please note that this conference is being recorded. It's now my pleasure to turn the floor over to Jared Harding. Jared, you may begin.

Jared Harding

Thanks, Adam, and thank you all for joining our third quarter 2018 earnings call. I'm 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 September 30, 2018. If you would 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, 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 30, 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. - President, CEO & Director of Holly Logistic Services LLC*

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

HEP generated solid results in the third quarter, allowing us to continue our track record of distribution growth, increasing our distribution to $0.665 per unit. This distribution marks the 56th consecutive increase since our IPO in 2004.

Despite the typical seasonality of UNEV and lower than normal volumes in and around HollyFrontier's Woods Cross refinery, third quarter financial results highlight the cash flow stability of HEP's business model, which is underpinned by long-term minimum volume commitments.

During the quarter, we continue to make progress on our previously announced organic growth projects. Construction of our diesel truck loading rack in Orla, Texas remains on budget, and we now expect this rack to be operational early next year.

We also continue to pursue opportunities to expand the capacity of our crude gathering system in the Permian, where we currently gather between 130,000 and 140,000 barrels per day.

Several small projects in the aggregate will expand gathering capacity by approximately 25,000 barrels per day. These projects require small capital and have strong return profiles and are expected to be completed by the end of the year.

And 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. As George mentioned, on October 19, Holly Energy Partners announced the quarterly distribution of $0.665 per LP unit, which represents a 3.1% increase over the distribution for the third quarter of 2017. This distribution is scheduled to be paid on November 8 to unitholders on record as of October 29.

During the third quarter, HEP generated distributable cash flow of $67 million, $7 million higher than the same period last year. This is primarily due to the acquisitions of the remaining interests in the SLC and Frontier pipelines as well as higher crude gathering volumes in the Permian Basin.

Our distribution coverage ratio was 0.98 for the quarter, coverage was adversely affected by HollyFrontier's Woods Cross refinery running at reduced rates as well as the typical seasonal factors around the UNEV pipeline during the quarter.

We anticipate higher earnings in the fourth quarter and continue to expect the coverage ratio will be -- to be 1x for the full year of 2018.

Capital expenditures for the quarter were $10 million, including approximately $3 million in maintenance CapEx and $2 million of CapEx reimbursed by HollyFrontier.

For the full year of 2018, we are forecasting total capital between $45 million and $55 million, which includes $9 million of maintenance CapEx and $7 million of reimbursable CapEx.

For third quarter of 2018, we recognized $40,000 deferred revenue from prior shortfalls billed to shippers. And as of September 30, HEP carried $5.7 million in deferred revenue on our balance sheet. In the fourth quarter of 2018, we anticipate recognizing $3.6 million of deferred revenue.

Interest expense increased $4 million compared to the third quarter of 2017, primarily due to the tack-on offering of an additional $100 million of our 6% senior notes completed in the third quarter of 2017 coupled with both higher average revolver balances and higher interest rate on those balances.

As of the end of the third quarter, our leverage was just under 4.2x debt to trailing 12 months adjusted EBITDA, and we now expect to reach 4x in early 2019.

Including cash and revolver availability, our liquidity is roughly $500 million. We are confident that our strong liquidity will enable us to achieve our planned organic growth despite the absence of an MLP equity market. And with that, I'll turn the call over to Adam for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from Spiro Dounis from Crédit Suisse.

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

Just wanted to start off on CapEx and good to hear the truck rack is still online for early next year. But just maybe looking past that, could you just give us any sense for what the backlog could look like on the organic CapEx side? And even if you can't point to maybe discrete projects, just how you're thinking about how you're going to allocate or how would you like to allocate capital next year and in 2020?

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

Spiro, it's Rich. I think we've historically run sort of $30 million to $50 million of organic capital at HEP. We were obviously a little bit elevated this year. I think we'll be elevated again next year. To your point, we are seeing a number of smaller projects that we can go ahead and do to grow the system particularly in the Permian.

So I think we do see some more of those. They're -- no one of them really is so large to call out. But again, we'll be running an elevated number next year. So it help?

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

Yes. That's appreciated. And then second one, I'm sure someone will going to ask it at some point, but I'll just get out of the way. I guess, just in light of the recent folding in one of your refining MLP peers, I guess, could you guys just remind us where you stand on the whole MLP structure? And I know and you and others understandably have been pretty frustrated with capital markets, but does a roll-up of the MLP into HFC become a viable option at some point? Or is that not on the radar?

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

So like -- we're trying to create as much value for our unitholders as possible. To your point, like there's no MLP or equity market today, it's closed. In the past 3 years, we've grown our distribution 20%, and our equity has declined 14%, 15%. And unfortunately, we're not alone there. I think (inaudible) is down roughly 25% at the same time period. So then at the same time, we've got this complete disconnect between the public and private markets in the midstream space. So it's -- we're in a tough spot. We don't know how -- whether the current state of this equity market is transitory, if it's permanent. We don't know how they will interact with the private market eventually, and I don't know how this is going to resolve itself. It has to but how that's going to happen. So very long winded way of saying there's no obvious strategic or corporate action to us at the moment. In the near term, we'll continue to look at all the options. To your point there, we've seen some folks do different things, so we're watching to see how that works and how well that works. And we'll continue to focus on the organic growth. We see, try and continue to reduce our leverage and expect to maintain a long-term coverage ratio of 1x.

Operator

(Operator Instructions) And our next question comes from Jeremy Tonet from JPMorgan.

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

This is Joe on for Jeremy. I just wanted to ask on the feasibility study for the refined products pipeline you announced in July. Wanted to see how that's progressing? And if the capacity you talked about earlier in the conference call is related to that or different?

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

Jeremy, we continue to evaluate other options to supply the Permian with diesel fuel. Going all the way to Midland is one option there. Another -- those series of options that we're pursuing, and we'll make a decision when the time is right for us.

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

Okay. And then maybe another one around a turnarounds and what you are expecting for the fourth quarter? I know on last quarter's conference call, you mentioned a turnaround in El Dorado, and it looks like that has some effect in the third quarter as well. Is that -- you expect to see a effect moving on into -- to Q4?

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

Yes, El Dorado came down, like you said, near the end of September and was planned to be down all of October and early part of November. So you'll see that flow through in the next quarterly results.

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

Just to add some color, that's not a huge impact. We are continuing to see some lower volumes in or around Woods Cross, and we expect to see that through the rest of the year just due to crude supply. So that will come through on both the crude side and UNEV a little bit.

Operator

And we do have another question from Spiro Dounis from Crédit Suisse.

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

Just had 1 more. Just curious, the -- taking out the remaining interest of SLC and Frontier seems to have been pretty good move, is been working out for you guys. And I believe you have 2 other pipelines, Osage and Cheyenne. Just curious if there's an option there and ability for you guys to take on additional interest on those pipelines as well?

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

That's always a possibility, but obviously, our partners would need to make a decision that they want to sell. There is interest in potentially expanding the line out of Guernsey to Cheyenne. So very early stages. They are evaluating that project. But as far as the acquisition itself, nothing imminent.

Operator

And we do have another question from Chris Sighinolfi from Jefferies.

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

Rich, just had a question on the credit facility borrowings. I know you talked about how equity markets are closed. There's -- you've been carrying a balance on that. I'm assuming that's still the lowest cost, that option for you. But just curious to your thoughts on terming that out at any point and just views around that.

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

Sure, Chris, I think, yes, to your point, that is our lowest cost source of financing right now. Obviously, with interest rates rising, it's not as attractive as it was a year ago, but it's far more attractive than the next best alternative. So we feel -- given strong underpinning of minimum bond commitments at HEP, we feel really comfortable holding a higher floating rate debt balance than you might typically see. So I think you'll see that position stay pretty stable. No intention to term anything else in the short term.

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

Okay. And can you remind us, is that just a LIBOR-linked rate?

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

Yes.

Operator

And if there are no further questions, I'll turn the floor back over to Jared for closing remarks.

Jared Harding

Thanks, Adam, and thanks everyone for joining the call today. Feel free to reach out if you have any follow-ups.

Operator

And this does conclude today's conference call. You may now disconnect. Thank you for joining, and have a great day.
