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HEP - Q4 2015 Holly Energy Partners LP Earnings Call

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PRESENTATION

Operator

Welcome to the Holly Energy Partners fourth-quarter 2015 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 Craig Biery. Craig, you may begin.

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

Thanks, Denise. And thanks to each of you for joining this afternoon. I'm Craig Biery, Investor Relations for Holly Energy Partners. Welcome to our fourth-quarter 2015 earnings call.

Joining us today are Mike Jennings, CO; Mark Plake, President; and Richard Voliva, Vice President and CFO. This morning we issued a press release announcing results for the quarter ending December 31, 2015. If you would like a copy of today's press release, you may find one on our website at hollyenergy.com.

Before Mike, 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's 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 statements are not guarantees of future outcomes.

Also, please note that information presented on today's call speaks only as of today, February 23, 2016. 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 Rich Voliva.

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

Thanks, Craig. Thanks to each of you for joining the call this afternoon. On January 22, Holly Energy Partners announced a quarterly distribution of $0.565 per unit, a6.6% increase over the same period in 2014. This distribution marks the 45th consecutive increase for HEP unitholders since our IPO in 2014, and represents an acceleration in year-over-year distribution growth and progress towards our 8% distribution growth rate target.

For the fourth quarter of 2015, Holly Energy Partners generated distributable cash flow of $53.6 million. DCF in the quarter was $11.8 million higher than the same period last year. We maintained a very strong distribution coverage ratio of 1.19 times for the quarter and 1.14 times for the full year of 2015.

Net income attributable to HEP in the fourth quarter was $40.5 million compared to $28.7 million for the same period in 2014. This increase was driven by higher volume, notably on our Permian Basin crude system and UNEV, as well as contributions from the acquisitions of the El Dorado processing units, El Dorado crude tanks and our 50% interest in the Frontier Pipeline Company.

Operating expenditures in the period totaled $26 million, including a little over $800,000 of reimbursable OpEx. Our capital expenditures for the quarter were $12 million including approximately $3.3 million in maintenance CapEx and $2.3 million of CapEx reimbursed by HollyFrontier. In 2016, excluding capital expenditures reimbursed by HFC, we expect to spend a total of $10 million to $15 million for maintenance CapEx and between $50 million and $60 million for expansion capital excluding acquisitions.

As of December 31, 2015 HEP had just over $1 billion of total debt outstanding, comprised of approximately $300 million of 6.5% notes due in 2020 and over $700 million drawn on our $850 million credit facility. Interest expense was $10.1 million in the fourth quarter, an increase of $1.4 million over the same period in 2014, which was driven by borrowings to fund acquisitions and capital expenditures.

For the fourth quarter of 2015 we recognized $1.7 million of deferred revenue from prior shortfalls billed to shippers. As of December 31, HEP carried $7.8 million in deferred revenue on our balance sheet. In the first quarter 2016 we anticipate recognizing approximately $6.9 million of deferred revenue.

Now, I'll turn the call over to Mike for a few comments.

Mike Jennings - *Holly Energy Partners, L.P. - CEO*

Thank you, Rich. As evidenced by our fourth-quarter and full-year results, 2015 was a solid year for HEP, both financially and operationally. As Rich mentioned, HEP announced a $0.01 increase to the quarterly distribution for the third quarter.

HEP's stable cash flow and long-term fee-based contracts have allowed the Company to execute its distribution growth strategy, targeting 8% despite a volatile commodity price environment. HEP has no direct commodity exposure and over 80% of our revenues are tied to minimum volume commitments. We expect HEP's conservative business model to continue to deliver solid financial results while supporting our positive growth outlook.

In the fourth quarter of 2015 HEP experienced record volumes on the UNEV product pipeline driven by an increase in third-party spot shipments. UNEV fourth-quarter volumes represented the increase of 40% over the same period last year. We remain confident in UNEV's organic growth potential now that the majority of Salt Lake City refineries are connected and able to capture the seasonal arbitrage of the Las Vegas versus Salt Lake City product markets.

Our southeastern New Mexico crude gathering systems saw an 18% increase in volumes year over year due to increased demand from HFC's Navajo refinery. We also continued to benefit from the reversal of the Centurion pipeline, which resulted in greater Permian gathering volumes associated with HFC supplying the El Dorado refinery with higher value Permian crude.

During 2015, HEP successfully completed several acquisitions, strategically expanding its logistics assets footprint. In March, we acquired a crude tank farm that serves HollyFrontier's El Dorado refinery. The tank farm, which receives crude delivered from Cushing via the Osage pipeline, and also locally produced crude via pipeline, provides the only local crude storage for the El Dorado refinery.

In August, we closed the acquisition of a 50% interest in the Frontier Pipeline Company, which owns a 289-mile crude pipeline running from Casper, Wyoming to Frontier Station in Utah. This pipeline will supply crude to HollyFrontier's Salt Lake City refinery and other regional refineries.

In November, HEP completed the acquisition of the newly constructed naphtha fractionation and hydrogen units at HollyFrontier's El Dorado refinery. These processing units provide stable cash flows to HEP through toll processing contracts that include long-term minimum volume commitments from HFC. Going forward, we continue to explore third-party acquisition opportunities and are also evaluating assets related to HollyFrontier's Woods Cross refinery expansion as a potential dropped an opportunity in the second half of 2016.

Now, I'd like to take the opportunity to introduce you to HEP's new President, Mark Plake. Since joining the Company in 1999, Mark has been an important part of the HFC team, primarily in commercial and market facing roles. We look forward to leveraging Mark's leadership and relationships to continue to profitably grow Holly Energy Partners. Mark?

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

Thanks, Mike. Good afternoon, everyone. I'm extremely pleased to join Holly Energy Partners. HEP is a high-quality business with a very strong growth outlook and I'm proud to be part of this organization. I have great confidence in our management team and the employees who keep us running.

My experience in working with a HEP as a customer for many years gives me a unique insight into the business, and I'm eager to build on HEP's record of success. I look forward to interacting with our investors and sell side analysts and sharing our first-quarter results with you in May.

And with that, I'll turn the call over to Denise for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Steve, Goldman Sachs.

Unidentified Participant - - *Analyst*

Hi, good afternoon. I just have a quick one. Now that the naphtha frac has been at HEP for a few months, are you satisfied that you dropped down the correct margin mix to HEP, or do you think that you could flex that ratio up or down in the future?

Mike Jennings - *Holly Energy Partners, L.P. - CEO*

Steve, I think the margin mix really results from the tariff versus the operating costs. As you know, HEP doesn't have commodity price risk in this transaction. The transaction came in at a multiple that we thought was attractive to HEP and also served HFC's economic needs. So, we like the template and I think that it's something we'll look to do more of as time rolls forward.

Unidentified Participant - - *Analyst*

Okay, great. That's it for me. Thank you.

Operator

Brian, Simmons & Company.

Unidentified Participant - - *Analyst*

Let's walk through a few things while we're here. How about the 8-K that was filed this morning, I know it's a very minor deal but maybe you could walk us through just the details there of potentially what I'm viewing as an asset swap with Frontier.

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

Brian, this is Rich. Basically, what we've done, the transaction between HEP at HFC is exactly as you described it, an asset swap. So, HEP is receiving 50% operating interest in the Osage pipeline, which runs from Cushing up to El Dorado and feeds the El Dorado refinery.

In return, HollyFrontier is going to be receiving the El Paso refined products terminal. And we've also committed to an expansion of what we call the South product system, the product pipeline running from Artesia down to El Paso.

Unidentified Participant - - *Analyst*

Is it going to shift any buckets noticeably that we should be thinking about for 2016, Rich?

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

I guess the best way to put this is there's a few moving parts here. I think net-net what will end up showing is Osage is going to be reported as an equity interest from our perspective. So, we'll see a little bit of a decline in revenue and operating expenses, an increase in our equity earnings. At the end of all that I think what you should think about is about $1 million a year in increased cash flow to HEP, is the net impact of all that.

Unidentified Participant - - *Analyst*

Okay. And then maybe a couple of moving pieces for the quarter, just trying to shape 2016 one way or the other. I think one of the biggest moves, at least based on my quick math, was the third-party refined product line under the pipeline segment. If you do it on rev per unit basis, it jumped pretty meaningfully in Q4. I know there's some seasonality there. The seasonality in 2015 looks similar to 2014, maybe more drastic with the benefits being in first quarter and fourth quarter. Is that the same trajectory we should think about for 2016? Is there anything and maybe in first quarter that might be even more meaningful. The $208 million that I'm calculating for Q4 looks pretty robust?

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

Brian, the main impact there, as you noted, a seasonal move in UNEV shipments. Obviously we've had a nice quarter there, particularly benefiting from the arbitrage between Las Vegas and Salt Lake City. So, we expect UNEV to continue to be somewhat seasonable, without question. Obviously we're expecting a good growth year from UNEV in 2016 with HollyFrontier's expansion at Woods Cross.

Mike Jennings - *Holly Energy Partners, L.P. - CEO*

But the walk up revenue for the quarter and first quarter is pretty high calorie unit revenue, as you emphasized, Brian, so that's probably what's driving that.

Unidentified Participant - - *Analyst*

Does the overall market, the anemic prices, does that accentuate that delta and therefore make those walk-up volumes even bigger than they would be normally on a seasonal basis? Or is it rather proportional and the $32 prominent price doesn't have much to do with it, it's still spread regardless?

Mike Jennings - *Holly Energy Partners, L.P. - CEO*

That's right. It's not a market-based tariff. It's going to be a fixed-rate tariff. It's just that people have greater incentive to ship on that line on a walk-up basis in the fourth and first quarters typically.

Unidentified Participant - - *Analyst*

And then, over on the terminal side, the affiliate revenue there, the $1 per unit jumped nicely in Q4, worked its way back towards what you'd recognize during most of 2014. Is that a better run rate for 2016? Or was there something abnormal in Q4 and we should go back to that $1.05 to $1.10 range for 2016? I know the volumes were down pretty noticeably during the fourth quarter, as well. I know there's some seasonality in there but they seemed to be an off tock with no association on the revenue loss. I don't know if there was some minimal volume commitments there that got paid but not shipped. Or how should we think about that?

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

Yes, I believe that is the case, Brian. Let us double check to make sure but I think that's effectively what happened, is we had some minimum volume. As you noted, volumes were down a little bit and so you recognize those minimums. That makes the revenue per barrel look a little higher.

Unidentified Participant - - *Analyst*

Okay. Happy to follow up with that afterwards. Appreciate the color, guys.

Operator

(Operator Instructions)

If there are no further questions I will turn the floor back over to Craig for any closing remarks.

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

Thanks again, everyone, 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 first-quarter results with you in May. Thank you.

Operator

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