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HEP - Q2 2018 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

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

Jared Harding

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

CONFERENCE CALL PARTICIPANTS

Jeremy Bryan Tonet *JP Morgan Chase & Co, Research Division - Senior Analyst*

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

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

PRESENTATION

Operator

Good afternoon, and welcome to Holly Energy Partners Second Quarter 2018 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, [Tasha]. I thank you all for joining our second 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 June 30, 2018. If you 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's a statement 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's statements are not guarantees of future outcomes. Also, please note that the information presented on today's call speaks only as of today, August 1, 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 reconciliation 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 earnings in the second quarter, which allowed us to continue our track record of distribution growth, increasing our distribution to \$0.66 per unit. This distribution marks the 55th consecutive distribution increase since our IPO in 2004. Despite typical seasonality experienced in the quarter, we are encouraged by the underlying fundamentals of our business, which provide stable cash flows, underpinned by long-term minimum volume commitments.

Our primary focus for 2018 has been to leverage our existing footprint to grow organically. I'm happy to report that we have successfully completed the previously announced debottleneck of the Malaga crude oil pipeline system, the expansion of the Salt Lake City and Frontier pipelines.

These projects were not only completed ahead of schedule, but under budget as well, which is a testament to the hard work and dedication of our team. As we look towards the second half of 2018, HEP plans to continue expanding our logistics infrastructure to serve the growing distillate demand in the Permian Basin.

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In May, we announced our intention to construct new truck loading rack in Orla, Texas. This facility will be able to deliver up to 30,000 barrels per day of diesel, that would otherwise be railed or trucked into the area. Construction is underway and we expect this rack to be operational by the end of the year.

In regards to third-party M&A, we continue to take a disciplined approach and leverage our relationship with HollyFrontier to explore acquisition opportunities.

In the second quarter, we completed the acquisition of the Catoosa lubricants terminal for approximately \$5 million. The terminal is roughly 20 miles from HollyFrontier's Tulsa lubricants plant and HollyFrontier is the primary customer. Acquisitions like Catoosa are excellent opportunities, and we believe there are more such opportunities across the HollyFrontier family. 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*

Thanks, George. As previously mentioned, on July 19, Holly Energy Partners announced the quarterly distribution of \$0.66 per unit, which represents a 4.3% increase over the distribution for the second quarter of 2017. Distribution is scheduled to be paid on August 9 to unitholders on record as of July 30.

During the quarter, HEP generated distributable cash flow \$65 million, \$4 million higher than the same period last year. Our distribution coverage ratio was 0.97x for the quarter. Coverage was adversely affected by typical seasonal factors on UNEV, but we expect a significant improvement in the second half of 2018, due to contractual tariff escalators effective on July 1. We continue to expect our coverage ratio to be 1x or higher for the full year 2018. Capital expenditures for the quarter were \$8.9 million, including approximately \$1 million maintenance CapEx and \$2.3 million of CapEx reimbursed by HollyFrontier.

For the full year of 2018, we are forecasting total CapEx between \$60 million and \$70 million, which includes \$8 million of maintenance CapEx and \$7 million of reimbursable CapEx.

In the second quarter of 2018, we recognized \$400,000 deferred revenue from prior shortfalls billed to shippers. As of June 30, HEP carried \$4.4 million in deferred revenue on our balance sheet. And in the third quarter, we anticipate recognizing less than \$100,000 of deferred revenue.

Interest expense increased \$3.9 million, compared to the second quarter of 2017, due to both the tack-on offering of an additional \$100 million of our 6% senior notes, which was completed in the third quarter of 2017 as well as higher interest rates on our revolving credit facility.

As we ended the second quarter, our leverage was roughly 4.2x debt to trailing 12 months adjusted EBITDA, and we still expect leverage to be at 4x by the end of 2018. Including cash and revolver availability, our current liquidity is over \$500 million. We are confident that this strong liquidity position will enable us to achieve our planned organic growth despite the weak MLP and equity market. And with that, I'll turn the call over to [Tasha], for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jeremy Tonet from JP Morgan.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I was just hoping you could touch a bit more on the feasibility study for the Permian product pipeline that you guys had just recently press-released there. Kind of what steps, going forward, should we be looking for and when do you expect the whole process to conclude?

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

Yes, Jeremy, this is George. I think it's a typical feasibility study process, where we're looking not only at our cost to get to other markets such as Midland, but also the market demand and pricing to get to those markets. So we're doing work on both sides of the equation to develop our cost and develop the benefits, volumes and potential tariff revenue for HEP. We don't have a specific guideline, but we expect to make good progress over the next quarter or so.

Jeremy Bryan Tonet - JP Morgan Chase & Co, Research Division - Senior Analyst

That's helpful. And as you think about the balance of the year here, just wondering if there's any items we should be watching out for -- those -- [which] refinery had issues. This quarter here, are there any turnarounds or other items we should be thinking about in the back half of the year? Or do you kind of expect just normal seasonality in 2018?

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

So generally -- generally we expect normal seasonality, but one thing I'll call out is we do have a planned turnaround, I think, HFC does at its El Dorado Refinery really in the fourth quarter. And we don't expect that to be a huge impact given the minimum volume commitments in and around that asset.

Operator

And the next question comes from the line of Justin Jenkins with Raymond James.

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

I guess, maybe quickly following up on Jeremy's question on diesel supply in the Permian. George, are you concerned about the number of competing projects that are looking to supply the Permian over the long term? Or how should we think about kind of the medium to longer-term picture of supply/demand for diesel in the region?

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

Well, I think the demand is obviously growing in the area. We're familiar with this market through the marketing we do through our Artesia refinery truck rack. We think Orla is the first natural extension from that, in that we already have tankage in that area, this pipeline supplies directly from HFC's Artesia refinery. So it's just a matter of building the rack as we've previously announced. We are seeing demand from not only our HollyFrontier owners, but also other customers to get diesel into the area. It's a market that's short product, it's being trucked and railed from other markets. The closer you can get to the actual drilling rig or well that's using the diesel, the better, especially as truck drivers are short supplying the Permian. There's always going to be competition for business. We're not afraid of competition, and we think we're well positioned to take advantage of that opportunity.

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

Perfect, that's great. Transitioning on the crude side, you mentioned the shortage of truck drivers in the Permian and that leads me to my next question on, maybe it's better for HFC's call tomorrow, but I'm curious if there's an opportunity to get more access to Permian barrels across the rest of the HFC refining system besides Artesia?



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

I'm not sure what you're getting at, Justin. You're talking about getting Permian barrels out to the other refineries or?

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

Yes.

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

Yes -- no, I think we've done quite a bit of that in the past. Again, probably better left for HFC to talk about that than HEP. But HFC is bringing barrels up from the Permian to Cushing primarily for El Dorado.

Operator

(Operator Instructions) Our next question comes from the line of Theresa Chen from Barclays.

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

Just wanted to ask about the parent's plans to acquire Red Giant Oil and given the logistics assets that sit there, any idea or intention for some of these assets to maybe make its way to the MLP?

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

Yes. I think we're probably better off leaving that question to the parent tomorrow.

Anything else, Theresa?

Operator

And as there are no other questions, I would like to turn the call back over to Jared, for any closing remarks.

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

Thanks, again, everyone, for joining. Feel free to reach out to investor relations if you have any follow-ups.

Operator

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



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