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EDITED TRANSCRIPT

HEP - Q1 2017 Holly Energy Partners LP Earnings Call

EVENT DATE/TIME: MAY 02, 2017 / 8:00PM GMT

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CORPORATE PARTICIPANTS

Craig Biery

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

CONFERENCE CALL PARTICIPANTS

Gabriel Philip Moreen *BofA Merrill Lynch, Research Division - MD*

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

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

PRESENTATION

Operator

Welcome to Holly Energy Partners First 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 Craig Biery. Craig, you may begin.

Craig Biery

Thanks, Kirk, and thanks to each of you for joining this afternoon. I'm Craig Biery, Director of Investor Relations for Holly Energy Partners. And welcome to our first quarter 2017 earnings call. Joining us today are George Damiris, President and CEO; and Richard Voliva, Senior Vice President and CFO.

This morning, we issued a press release announcing results for the quarter ending March 31, 2017. 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, 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, May 2, 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 Damiris.

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

Thanks, Craig. And thanks to all of you for joining us this afternoon. We're very pleased with our first quarter results, which demonstrate our ability to produce solid distributable cash flow despite headwinds during the period. Our financial performance has enabled us to increase our distribution for the 50th consecutive quarter and continue progress towards our distribution growth target of 8%. HEP's fee-based business model, supported by long-term minimum volume commitments, provides us with a strong foundation for continued growth.

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In the first quarter, the Salt Lake City crude pipeline experienced an outage, which reduced overall crude throughput at Salt Lake City refineries. The 28-day interruption in February impacted our equity earnings as we are a 25% owner of the pipeline. The Salt Lake City pipeline is currently fully operational and running at normal rates. Despite the Salt Lake City pipeline outage, HEP's unit volumes saw only a slight decrease over the same period last year aided by a healthy arbitrage into the Las Vegas market in January. Our outlook remains positive for UNEV's organic growth potential now that the majority of Salt Lake City refineries are connected, and local refinery expansions are fully operational.

Also in the quarter, HollyFrontier's Navajo refinery conducted a major plant maintenance turnaround, which reduced the refinery's crude throughput and product output. As a result, HEP's assets in the Southwest region saw a decrease in transportation and terminal volumes.

Going forward, we'll continue to leverage our logistics capabilities and HFC's refining footprint to pursue organic growth third-party acquisition opportunities. With the quality of location of our assets, talented employee base and supportive general partner, we remain confident in our growth strategy.

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 SVP of Holly Logistic Services, L.L.C*

Thank you, George. On April 27, Holly Energy Partners announced a quarterly distribution of $0.62 per unit, a 7.8% increase over the same period in 2016. And as George mentioned, we're on track to meet our 8% distribution growth target. This distribution is scheduled to be paid on May 15 to unitholders on record as of May 8.

For the first quarter of 2017, HEP generated distributable cash flow of $57.3 million, $1.9 million higher than the same period last year. We ran a distribution coverage ratio of 1.0x for the quarter despite both planned and unplanned maintenance surrounding our asset base.

Net income attributable to HEP for the first quarter was $25.6 million compared to $43 million for the same period in 2016. The decrease is primarily due to a charge of $12.2 million related to the early redemption of our $300 million 6.5% senior notes due in 2020 as well as a reduction in pipeline revenues of $12.4 million, primarily driven by the turnaround at HollyFrontier's Navajo refinery. Excluding the loss from the early extinguishment of debt, debt income attributable to HEP for the quarter would be $37.8 million.

Operating expenditures in the period totaled $32.5 million, including $1.3 million of OpEx reimbursed by HollyFrontier. Our capital expenditures for the quarter were $8.3 million, including approximately $800,000 in maintenance CapEx and about $900,000 of CapEx reimbursed by HFC. 2017, excluding CapEx reimbursed by HFC, we expect to spend approximately $10 million for maintenance capital and approximately $30 million for expansion capital, excluding any acquisitions.

As of March 31, 2017, HEP had over $1.2 billion of total debt outstanding, comprised of $400 million of 6% notes due in 2024 and approximately $850 million drawn on our $1.2 billion credit facility. As mentioned earlier, on January 4 of this year, we redeemed our 6.5% notes with revolver borrowings, reducing our quarterly interest expense by roughly $2.6 million.

In the first quarter, we raised $40.3 million from the sale of LP units via our continuous offering program. Including cash and revolver availability, we had approximately $360 million of liquidity at the end of the quarter. We are confident that our current liquidity and ability to access the capital markets will enable us to achieve future growth, both organically and through M&A.

For the first quarter of 2017, we recognized $2.1 million of deferred revenue from prior shortfalls billed to shippers. As of March 31, HEP carried $6.2 million in deferred revenue on our balance sheet. In the second quarter for 2017, we anticipate recognizing approximately $600,000 of deferred revenue.

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

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QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And your first question comes from the line of Theresa Chen from Barclays Capital.

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

On the topic of turnarounds, looking into your parent's guidance, how much of an impact should we see on the HEP level from the Tulsa turnaround scheduled for fourth quarter of this year?

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

Theresa, it's Rich. I don't think it will be substantial. The way I would probably frame that is, what, the area of the asset base that has probably the most headroom, if you will, over minimum volume commitments that's in and around Navajo. Frankly, that's where you are going to see the outsized impact of a turnaround. The only thing to keep in mind that Tulsa is that we turn that refinery around essentially in 2 pieces, if you will. So the full plant doesn't come down that much or the plant doesn't come down similar to what we just had with Navajo. So it mutes the impact.

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

Got it. And then just looking at the quarterly results, does paid per barrel on the terminalling side looked as there was an uptick and looked higher than the run-rate over the past few quarters? Is there anything to call out there? And -- or is it sustainable?

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

Bear with us just one second, Theresa. We're just fishing the number out, so we make we're looking at the right thing. So long story short, I don't think there is anything in particular to call out this quarter. Again, I'd point you to the fact that we did have Navajo down, so several of terminals that were impacted in the system. Tucson, El Paso obviously is out, Bloomfield, Moriarty. So there's a few of them that were down and disproportionally down this quarter. So I think it's nothing more complicated than that.

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

Okay. So following the Q1 results, do you still expect to achieve your general coverage target of 1.1 to 1.2x for this year?

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

Yes, I think, we're -- we've talked about a target of 1 to 1.2x, and we feel very comfortable with that range.

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

Okay. And can you just remind us what your long-term leverage target is?

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

Sure. I think, long-term, we target 4x debt to EBITDA running a little bit over that right now, although we brought that down a little bit this quarter. Given our business model, we're comfortable running a little bit over that. But again, our target is 4x.

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Operator

(Operator Instructions) Your next question comes from the line of Justin Jenkins from Raymond James.

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

Just a couple maybe strategic ones for me. You talked about the opportunities maybe in the M&A market. Curious what you think maybe from a regional perspective, simply building upon HollyFrontier's asset base seems to make the most sense. Is that the goal, at least, from an overarching perspective in terms of M&A?

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

Yes, I think that's a good way of thinking about it. We have the most competitive advantage in most sense to grow, both organically and via M&A, in the areas where we already have an asset base.

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

Okay, great. And then one of your customers is in the process of an M&A transaction. I know you probably don't want to talk about anything specific related to that customer, but any concerns or opportunities that might arise from that transaction unfolding?

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

Yes, like you say, it's not right for us to speak for somebody else. But from our perspective, we don't see anything changing.

Operator

Your next question comes from the line of Gabriel Moreen from Bank of America Merrill Lynch.

Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

Two broader questions on my end. One is just an update on, I guess, Permian organic growth opportunities to the extent where you find yourself in those. And number two would just be around the whole GP/IDR restructuring and to what extent that's on your minds at this point.

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

Sure. On the Permian, we continue to look for opportunities. The growth continues and, in many cases, exceeds what is in the public domain. Having said that, as you've probably seen from various recent M&A transactions, there are a lot of mind-chasing deals in the Permian, so it was very competitive. So we're going to continue to look and continue to believe we have opportunities in the Permian. But again, it's going to be very competitive. But we feel confident we're going to find our fair share of the opportunities. Regarding the IDRs, we continue to work it. We've been a little bit preoccupied with our PCLI acquisition integrating that into HollyFrontier. So a lot of the people and resources we needed to address the IDRs are just not being freed up from the PCLI activities. We'll continue to evaluate it and will probably be in a position to further address in subsequent quarterly calls.

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Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

So let me just follow up on that. I mean, is it the viewpoint that it seems -- I mean, I understand the personnel bandwidth, but is it the view that considering how many others are moving I guess to address the IDRs that it's, I guess, you, and the board's, feeling that this is an issue that now has to be dealt with? Or...

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

We think it makes a lot of sense to look at it. At the end of day, it's going to have to be something that's right for both the GP and the LT, obviously. But it seems to make a lot of sense, but we have a lot of Is to dot and Ts to cross before we get to a point where we can make a call on this one.

Operator

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

Craig Biery

Thanks, again, 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 second quarter results with you in August.

Operator

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

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