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HEP - Q2 2017 Holly Energy Partners LP Earnings Call

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CORPORATE PARTICIPANTS

Craig Biery

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

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*

CONFERENCE CALL PARTICIPANTS

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

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

PRESENTATION

Operator

Welcome to Holly Energy Partners Second Quarter 2017 Conference Call and Webcast. (Operator Instructions) Please note that this conference is being recorded.

It is now my pleasure to turn the call over to Craig Biery. Craig, you may begin.

Craig Biery

Thanks, Emily, 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 second 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 June 30, 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 provision 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, August 1, 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, President & Director of Holly Logistic Svcs LLC

Thanks, Craig. And thanks to each of you for joining the call this afternoon. On July 27, Holly Energy Partners announced a quarterly distribution of \$0.6325 per unit, an 8.1% increase over the same period in 2016. This distribution will be paid on August 14 to unitholders on record as of August 7.

This distribution marks the 51st consecutive increase and exceeds our distribution growth target of 8%, while still maintaining a coverage ratio greater than 1.



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In the second quarter, HEP's total volumes increased by 6% over the same period last year. This increase is primarily due to an increase in intermediate shipment and additional volumes associated with our refinery process unit and HollyFrontier's Woods Cross refinery, which was acquired in the fourth quarter of 2016.

Further, unit volumes were 20% higher than the comparable period in 2016 now that the majority of the (inaudible) to the refiners are connected and HFC's Woods Cross refinery expansion was complete.

While most of HollyFrontier's annual maintenance -- I'm sorry, with most of HollyFrontier's annual maintenance completed in the first quarter, we remain optimistic about our volume growth outlook for the remainder of this year.

We are very pleased with our solid financial performance. We will maintain our focus on growing the business. We continue to leverage our logistics capabilities and HollyFrontier's refining footprint to explore third-party acquisition opportunities.

With the quality and location of our assets, talented employee base, and support of a 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 Senior VP of Holly Logistic Services, L.L.C*

Thank you, George. For the second quarter of 2017, Holly Energy Partners generated distributable cash flow of \$60.9 million, an increase of \$5.2 million or 9% over the same period last year.

Distribution coverage for the quarter was 1.03x, in line with our target coverage ratio of 1 to 1.2x.

Net income attributable to HEP for the second quarter was \$41.3 million compared to \$39.1 million for the same period in 2016. This increase was driven by recent acquisitions, including the Woods Cross refinery processing unit drop down in October 2016 and a 50% interest in the Cheyenne Pipeline acquired in June of 2016.

Operating expenditures in the period totaled \$34 million, including \$2 million of OpEx reimbursed by HollyFrontier. Our capital expenditures for the quarter were \$8.6 million, including \$2.2 million in maintenance CapEx and roughly \$300,000 of CapEx reimbursed by HFC.

In 2017, excluding CapEx reimbursed by HFC, we expect to spend approximately \$10 million for maintenance capital and approximately \$30 million for expansion capital, excluding acquisitions.

As of June 30, HEP had approximately \$1.2 billion of total debt outstanding, comprised of \$400 million of 6% notes due in 2024; the balance funded on our credit facility.

Interest expense was \$13.7 million in the second quarter, representing an increase of \$2.4 million over the same period in 2016. On July 27, HEP's credit agreement was amended, increasing the size of our facility to \$1.4 billion from \$1.2 billion, and extending the maturity to July of 2022.

During the second quarter, HEP issued approximately 400,000 units under our continuous offering program, providing \$13 million in net proceeds. We are confident that our current liquidity and the ability to access the capital markets will enable us to achieve future growth both organically and through acquisitions.

In the second quarter of 2017, we recognized roughly \$600,000 of deferred revenue from prior shortfalls billed to shippers. And as of June 30, HEP carried \$8 million in deferred revenue on our balance sheet.

In the third quarter of 2017, we anticipate recognizing approximately \$750,000 of deferred revenue.



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

QUESTIONS AND ANSWERS

Operator

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

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

In terms of the growth guidance that you've reiterated, do you think you'll need to execute another transaction later this year, either another drop-down or a third-party acquisition to achieve that 8% growth guidance? Or are you comfortable with your existing asset base and then possibly just having thinner coverage for the year?

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*

No, Theresa, I think we're anticipating some better volumes in the back half of the year. And no, we don't see the need for a transaction this year. We feel comfortable with our guidance.

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

Okay. And in terms of just the base business then, for the volumes and the average fee per barrel that showed up in Q2, is that a pretty good run rate currently building on some additional volumes for the back half just because the first quarter was affected by the downtime, and Navajo's numbers look a little volatile from quarter-to-quarter.

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. So -- there's obviously a seasonality with UNEV, in particular, right, that's going to filter in here. But yes, to your point, the first quarter is probably exceptional in that sense. So -- and I think year-over-year, that kind of per-barrel number should look comparable. That's probably a better way to think of it, right?

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

Got it. And speaking of UNEV, can you give us any indication of how those volumes are running in the third quarter?

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*

So far, a little bit better. We expect the seasonality that's always existed on UNEV is going to continue. So much stronger shipments in the fourth and the first quarter than the second and the third.

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

Sure, but on a year-over-year basis?



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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*

Year-over-year basis is definitely up a little bit, not a huge amount.

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

Got it. And just kind of turning to the more strategic outlook for HEP. Where do you think the next wave of growth or the next wave of spending is for the partnership or at least the opportunities?

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

Yes. I think we're going to continue to leverage our existing asset base for organic growth. I think you will see additional volumes associated with activity at HollyFrontier. We're running with those refineries. We're going to continue to leverage our strategy of finding opportunities for HEP to participate in systems that HFC is currently using from an incumbent. And we think the Permian should present some opportunities as well as other acquisition opportunities.

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

Got it. And George, I'm very glad you brought up the Permian and potential acquisition opportunities. As a Permian operator, granted on the downstream side, but can you kind of comment on the competitive dynamic for assets in the basin, the closures, the wellhead, particularly as a rather large and expensive gathering asset has come to market recently in a more public way?

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

Well, there's no question, it's very competitive in the Permian. There's a lot of money-chasing deals in the Permian. So we're not going to get carried away emotionally and do something in the Permian unless it makes sense. But we have a strong asset base to which to leverage, and we'll take advantage of that where it makes sense.

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

Okay. And can you just remind us of what your internal criteria is for acquisitions?

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

All right. So Theresa, we're kind of fairly standard, right? We look at discounted cash flows and returns versus cost of capital. And are obviously also always mindful of accretion and dilution to our limited partners. So it's sort of forms 2 criteria at the end of the day.

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

Okay. But is there like a numerical hurdle that you have to meet for every acquisition? Or does it just depend...

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

No. It depends, right? Every possible transaction comes with a different risk profile. And so to set one hurdle would ignore that fact.



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Operator

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

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

I think Theresa hit on a bit of what I had, but maybe thinking about the IDRs. George, I know you said last quarter, it makes a lot of sense to look at but there was a lot on your plate with integrating PCLI into the HollyFrontier family. Any update you can share on the current thinking as it relates to cost to capital and the IDR structure?

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, it's Rich. So I -- we would just say the same thing that we've been saying, basically, which is we're aware of the market and the cost of capital issues and it is on our list of things to work on this year. So we're working on it.

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

Fair enough. I had to try. Looking at maybe a housekeeping item. On the lines of operation, it seems like refinery processing units have a sizable drop in revenue in 2Q from 1Q even though throughputs went up. Is it something in particular that caused that? Or should we look at maybe a run rate of the balance of the 2 quarters? Or how should we think about that?

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

Yes. I think we had some operating issues in the second quarter. And I would probably view the first quarter as being more indicative than the second, but I think even a little bit higher than the first quarter wouldn't be out of the question as well.

Operator

(Operator Instructions)

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

Emily, does it look like we have any other question? Looks like we may have lost her. But 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 third quarter results with you in November.

Operator

My apologies for that. This concludes today's call. You may now disconnect. Thanks for joining, and have a great day.



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