HOLLY ENERGY PARTNERS LP
Form 10-Q
May 01, 2013

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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FORM 10-Q

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(Mark One)

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ____________ to _____________
Commission File Number: 1-32225

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HOLLY ENERGY PARTNERS, L.P.
(Exact name of registrant as specified in its charter)

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| | |
|---|---|
| Delaware<br>(State or other jurisdiction of incorporation or organization) | 20-0833098<br>(I.R.S. Employer Identification No.) |

2828 N. Harwood, Suite 1300
Dallas, Texas 75201
(Address of principal executive offices), (Zip code)
(214) 871-3555
(Registrant’s telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes ¨ No ý

The number of the registrant’s outstanding common units at April 26, 2013 was 58,657,048.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of the federal securities laws. All statements, other than statements of historical fact included in this Form 10-Q, including, but not limited to, those under “Results of Operations” and “Liquidity and Capital Resources” in Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part I are forward-looking statements. Forward looking statements use words such as “anticipate,” “project,” “expect,” “plan,” “goal,” “forecast,” “intend,” “should,” “would,” “believe,” “may,” and similar expressions and statements regarding our plans and objectives for future operations. These statements are based on our beliefs and assumptions and those of our general partner using currently available information and expectations as of the date hereof, are not guarantees of future performance and involve certain risks and uncertainties. Although we and our general partner believe that such expectations reflected in such forward-looking statements are reasonable, neither we nor our general partner can give assurance that our expectations will prove to be correct. All statements concerning our expectations for future results of operations are based on forecasts for our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements are subject to a variety of risks, uncertainties and assumptions. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated, projected or expected. Certain factors could cause actual results to differ materially from results anticipated in the forward-looking statements. These factors include, but are not limited to:

- risks and uncertainties with respect to the actual quantities of petroleum products and crude oil shipped on our pipelines and/or terminalled, stored or throughput in our terminals;
- the economic viability of HollyFrontier Corporation, Alon USA, Inc. and our other customers;
- the demand for refined petroleum products in markets we serve;
- our ability to purchase and integrate additional operations in the future successfully;
- our ability to complete previously announced or contemplated acquisitions;
- the availability and cost of additional debt and equity financing;
- the possibility of reductions in production or shutdowns at refineries utilizing our pipeline and terminal facilities;
- the effects of current and future government regulations and policies;
- our operational efficiency in carrying out routine operations and capital construction projects;
- the possibility of terrorist attacks and the consequences of any such attacks;
- general economic conditions; and
- other financial, operational and legal risks and uncertainties detailed from time to time in our Securities and Exchange Commission filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, the forward-looking statements that are referred to above. When considering forward-looking statements, you should keep in mind the known material risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2012 in “Risk Factors” and in this Form 10-Q in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” All forward-looking statements included in this Form 10-Q and all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements speak only as of the date made and, other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED BALANCE SHEETS
(Unaudited)

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| | (In thousands, except unit data) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $18,193 | $5,237 |
| Accounts receivable: | | |
| Trade | 6,073 | 7,126 |
| Affiliates | 31,055 | 31,594 |
| | 37,128 | 38,720 |
| Prepaid and other current assets | 3,475 | 3,619 |
| Total current assets | 58,796 | 47,576 |
| | | |
| Properties and equipment, net | 955,920 | 960,535 |
| Transportation agreements, net | 92,860 | 94,596 |
| Goodwill | 256,498 | 256,498 |
| Investment in SLC Pipeline | 25,011 | 25,041 |
| Other assets | 9,101 | 9,864 |
| Total assets | $1,398,186 | $1,394,110 |
| | | |
| LIABILITIES AND PARTNERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable: | | |
| Trade | $7,429 | $7,045 |
| Affiliates | 4,917 | 4,985 |
| | 12,346 | 12,030 |
| | | |
| Accrued interest | 2,366 | 10,226 |
| Deferred revenue | 6,627 | 8,901 |
| Accrued property taxes | 2,721 | 2,688 |
| Other current liabilities | 2,421 | 1,905 |
| Total current liabilities | 26,481 | 35,750 |
| | | |
| Long-term debt | 811,913 | 864,674 |
| Other long-term liabilities | 14,723 | 15,433 |
| Deferred revenue | 15,469 | 11,494 |
| | | |
| Class B unit | 15,418 | 13,903 |
| | | |
| Equity: | | |
| Partners' equity: | | |
| Common unitholders (58,657,048 and 56,782,048 units issued and outstanding | 560,590 | 502,809 |

| | | |
|---|---|---|
| at March 31, 2013 and December 31, 2012, respectively) | | |
| General partner interest (2% interest) | (145,118) | (145,877) |
| Accumulated other comprehensive loss | (2,868) | (4,279) |
| Total partners’ equity | 412,604 | 352,653 |
| Noncontrolling interest | 101,578 | 100,203 |
| Total equity | 514,182 | 452,856 |
| Total liabilities and equity | $1,398,186 | $1,394,110 |

See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 [1] |
| | (In thousands, except per unit data) | |
| Revenues: | | |
| Affiliates | $61,512 | $56,531 |
| Third parties | 12,786 | 11,884 |
| | 74,298 | 68,415 |
| Operating costs and expenses: | | |
| Operations | 25,865 | 20,475 |
| Depreciation and amortization | 14,154 | 14,300 |
| General and administrative | 3,232 | 2,039 |
| | 43,251 | 36,814 |
| Operating income | 31,047 | 31,601 |
| Other income (expense): | | |
| Equity in earnings of SLC Pipeline | 657 | 831 |
| Interest expense | (12,484) | (10,405) |
| Interest income | 103 | — |
| Loss on early extinguishment of debt | — | (2,596) |
| Gain on sale of assets | 2,022 | — |
| | (9,702) | (12,170) |
| Income before income taxes | 21,345 | 19,431 |
| State income tax expense | (56) | (75) |
| Net income | 21,289 | 19,356 |
| Allocation of net loss attributable to Predecessors | — | 1,861 |
| Allocation of net loss (income) attributable to noncontrolling interests | (2,890) | 557 |
| Net income attributable to Holly Energy Partners | 18,399 | 21,774 |
| General partner interest in net income, including incentive distributions | (6,231) | (5,503) |
| Limited partners' interest in net income | $12,168 | $16,271 |
| Limited partners' per unit interest in earnings—basic and diluted | $0.21 | $0.30 |
| Weighted average limited partners' units outstanding | 56,990 | 54,722 |

[1] Restated as described in Note 1.

See accompanying notes.

HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

| | Three Months Ended March 31, | |
|---|---|---|
| | 2013 | 2012 [1] |
| | (In thousands) | |
| Net income | $21,289 | $19,356 |
| Allocation of net loss attributable to Predecessors | — | 1,861 |
| Net income before noncontrolling interests | 21,289 | 21,217 |
| | | |
| Other comprehensive income (loss): | | |
| Change in fair value of cash flow hedge | 562 | (354) |
| Amortization of unrealized loss attributable to discontinued cash flow hedge | 849 | 1,274 |
| Other comprehensive income (loss) | 1,411 | 920 |
| Comprehensive income before noncontrolling interest | 22,700 | 22,137 |
| Allocation of comprehensive (income) loss to noncontrolling interests | (2,890) | 557 |
| Comprehensive income attributable to Holly Energy Partners | $19,810 | $22,694 |

[1] Restated as described in Note 1.

See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Three Months Ended March 31, 2013 | 2012 (1) |
|---|---|---|
| | (In thousands) | |
| Cash flows from operating activities | | |
| Net income | $21,289 | $19,356 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 14,154 | 14,300 |
| Gain on sale of assets | (2,022) | — |
| Amortization of deferred charges | 1,379 | 2,091 |
| Equity in earnings of SLC Pipeline, net of distributions | 30 | (81) |
| Amortization of restricted and performance units | 1,123 | 943 |
| (Increase) decrease in current assets: | | |
| Accounts receivable—trade | 1,053 | (1,897) |
| Accounts receivable—affiliates | 539 | (1,219) |
| Prepaid and other current assets | 145 | 328 |
| Increase (decrease) in current liabilities: | | |
| Accounts payable—trade | (1,808) | (5,749) |
| Accounts payable—affiliates | 253 | (14) |
| Accrued interest | (7,860) | (6,473) |
| Deferred revenue | 1,686 | (592) |
| Accrued property taxes | 33 | (395) |
| Other current liabilities | 531 | 771 |
| Other, net | 354 | 2,734 |
| Net cash provided by operating activities | 30,879 | 24,103 |
| | | |
| Cash flows from investing activities | | |
| Additions to properties and equipment | (6,645) | (17,011) |
| Proceeds from sale of assets | 2,481 | — |
| Net cash used for investing activities | (4,164) | (17,011) |
| | | |
| Cash flows from financing activities | | |
| Borrowings under credit agreement | 57,000 | 36,000 |
| Repayments of credit agreement borrowings | (110,000) | (81,000) |
| Proceeds from issuance of senior notes | — | 294,750 |
| Proceeds from issuance of common units | 73,444 | — |
| Repayment of notes | — | (232,711) |
| Contributions from UNEV joint venture partners | — | 14,962 |
| Distributions to HEP unitholders | (32,709) | (29,716) |
| Contribution from general partner | 1,499 | — |
| Purchase of units for incentive grants | (2,719) | (1,283) |
| Deferred financing costs | — | (1,123) |
| Other | (274) | (192) |
| Net cash used by financing activities | (13,759) | (313) |

| | | |
|---|---|---|
| Cash and cash equivalents | | |
| Increase for the period | 12,956 | 6,779 |
| Beginning of period | 5,237 | 6,369 |
| End of period | $18,193 | $13,148 |

[1] Restated as described in Note 1.
See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY
(Unaudited)

| | Common Units | General Partner Interest | Accumulated Other Comprehensive Income (Loss) | Noncontrolling Interest | Total Equity |
|---|---|---|---|---|---|
| | (In thousands) | | | | |
| Balance at December 31, 2012 | $502,809 | $(145,877) | $(4,279) | $100,203 | $452,856 |
| Issuance of common units | 73,444 | — | — | — | 73,444 |
| Net income | 14,310 | 5,604 | — | 1,375 | 21,289 |
| Other comprehensive income | — | — | 1,411 | — | 1,411 |
| Capital contribution | — | 1,499 | — | — | 1,499 |
| Distributions to HEP unitholders | (26,687) | (6,022) | — | — | (32,709) |
| Purchase of units for restricted grants | (2,924) | — | — | — | (2,924) |
| Amortization of restricted and performance units | 1,123 | — | — | — | 1,123 |
| Class B unit accretion | (1,485) | (30) | — | — | (1,515) |
| Other | — | (292) | — | — | (292) |
| Balance March 31, 2013 | $560,590 | $(145,118) | $(2,868) | $101,578 | $514,182 |

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1: Description of Business and Presentation of Financial Statements

Holly Energy Partners, L.P. ("HEP") together with its consolidated subsidiaries, is a publicly held master limited partnership which is 39% owned (including the 2% general partner interest) by HollyFrontier Corporation ("HFC") and its subsidiaries. In these consolidated financial statements, the words "we," "our," "ours" and "us" refer to HEP unless the context otherwise indicates.

We own and operate petroleum product and crude oil pipelines and terminal, tankage and loading rack facilities that support HFC's refining and marketing operations in the Mid-Continent, Southwest and Rocky Mountain regions of the United States and Alon USA, Inc.'s ("Alon") refinery in Big Spring, Texas. Additionally, we own a 75% interest in UNEV Pipeline, LLC ("UNEV"), which owns a 400-mile, 12-inch refined products pipeline running from Woods Cross, Utah to Las Vegas Nevada (the "UNEV Pipeline"), product terminals near Cedar City, Utah and Las Vegas, Nevada and related assets, and a 25% interest in SLC Pipeline LLC, which owns a 95-mile intrastate crude oil pipeline system (the "SLC Pipeline") that serves refineries in the Salt Lake City, Utah area.

We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling and storing refined products and other hydrocarbons and providing other services at our storage tanks and terminals. We do not take ownership of products that we transport, terminal or store, and therefore, we are not directly exposed to changes in commodity prices.

The consolidated financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the "SEC"). The interim financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair presentation of our results for the interim periods. Such adjustments are considered to be of a normal recurring nature. Although certain notes and other information required by U.S. generally accepted accounting principles ("GAAP") have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Form 10-K for the year ended December 31, 2012. Results of operations for interim periods are not necessarily indicative of the results of operations that will be realized for the year ending December 31, 2013.

On January 16, 2013, a two-for-one unit split was paid in the form of a common unit distribution for each issued and outstanding common unit to all unitholders of record on January 7, 2013. All references to unit and per unit amounts in this document and related disclosures have been adjusted to reflect the effect of the unit split for all periods presented.

In March 2013, we closed on a public offering of 1,875,000 of our common units. Additionally, an affiliate of HFC, as a selling unitholder, closed on a public sale of 1,875,000 of its HEP common units. We used our net proceeds of $73.4 million to repay indebtedness incurred under our credit facility and for general partnership purposes. Amounts repaid under our credit facility may be reborrowed from time to time, and we intend to reborrow certain amounts to fund capital expenditures.

The financial information for the three months ended March 31, 2012, included in the accompanying financial statements and notes thereto were revised from the amounts previously reported for that period due to accounting rules that require retrospective restatement of previously reported results in cases of business combinations between entities under common control. We have therefore included the results of UNEV prior to our acquisition on July 12, 2012, herein referred to as results attributable to the Predecessor. See Note 2 below for additional information on the UNEV acquisition. Additional revisions were made in order to correct certain immaterial items in previously reported amounts. These revisions reduced net income attributable to Holly Energy Partners for the three months ended March 31, 2012 by $0.2 million, with no impact on the limited partners' per unit interest in net earnings - basic and diluted and were comprised principally of an adjustment of depreciation expense related to certain property and equipment. For more information about these revisions, see the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012.

New Accounting Pronouncements

Presentation of Comprehensive Income

Effective January 1, 2013, we adopted the accounting standard update that requires the disclosure of significant amounts reclassified out of accumulated other comprehensive income by component either on the face of the financial statements or in the notes. The adoption of this accounting standard did not have an impact on our financial condition, results of operations or cash flows.

HOLLY ENERGY PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

## Note 2: Acquisitions

### UNEV Pipeline Interest Acquisition

On July 12, 2012, we acquired HFC's 75% interest in UNEV. We paid consideration consisting of $260.0 million in cash and 2,059,800 of our common units. We paid an additional $0.9 million to HFC for a post-closing working capital adjustment. Also under the terms of the transaction, we issued to HFC a Class B unit comprising a noncontrolling equity interest in a wholly-owned subsidiary subject to redemption to the extent that HFC is entitled to a 50% interest in our share of annual UNEV earnings before interest, income taxes, depreciation, and amortization above $30 million beginning July 1, 2016 and ending in June 2032, subject to certain limitations. Such contingent redemption payments are limited to a maximum payment amount calculated as described below. However, to the extent earnings thresholds are not achieved, no redemption payments are required. Contemporaneously with this transaction, HFC (our general partner) agreed to forego its right to incentive distributions of up to $1.25 million per quarter over twelve consecutive quarterly periods following the closing of the transaction and up to an additional four quarters in certain circumstances. The Class B unit increases with each foregone incentive distribution as described above and by a 7% factor compounded annually on the outstanding unredeemed balance through its expiration date. At our option, we may redeem, in whole or in part, the Class B unit at the current unredeemed value based on the calculation described. The Class B unit had a value of $13.9 million at December 31, 2012 and $15.4 million at March 31, 2013.

Noncontrolling interests reported in the consolidated statements of income include the minority partner's 25% interest in UNEV and income attributable to the Class B unit representing foregone incentive distribution rights and the 7% accretion factor, which collectively amounted to $2.9 million for the three months ended March 31, 2013.

We are a consolidated variable interest entity of HFC. Therefore, this transaction was recorded as a transfer between entities under common control and reflects HFC's carrying basis in UNEV's assets and liabilities. We have retrospectively adjusted our financial position and operating results as if UNEV were a consolidated subsidiary for all periods while we were under common control of HFC. For the three months ended March 31, 2012, our consolidated statement of income includes Predecessor revenues from UNEV of $3.9 million and Predecessor net losses of $1.9 million.

## Note 3: Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt and interest rate swaps. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. Debt consists of outstanding principal under our revolving credit agreement (which approximates fair value as interest rates are reset frequently at current interest rates) and our fixed interest rate senior notes.

Fair value measurements are derived using inputs (assumptions that market participants would use in pricing an asset or liability) including assumptions about risk. GAAP categorizes inputs used in fair value measurements into three broad levels as follows:

- (Level 1) Quoted prices in active markets for identical assets or liabilities.
- (Level 2) Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.

- (Level 3) Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes valuation techniques that involve significant unobservable inputs.

The carrying amounts and estimated fair values of our senior notes and interest rate swaps were as follows:

HOLLY ENERGY PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

| Financial Instrument | Fair Value Input Level | March 31, 2013 Carrying Value (In thousands) | March 31, 2013 Fair Value | December 31, 2012 Carrying Value | December 31, 2012 Fair Value |
|---|---|---|---|---|---|
| Liabilities: | | | | | |
| Senior notes: | | | | | |
| 6.5% senior notes | Level 2 | $295,438 | $318,750 | $295,275 | $321,000 |
| 8.25% senior notes | Level 2 | 148,475 | 161,813 | 148,399 | 163,125 |
| | | 443,913 | 480,563 | 443,674 | 484,125 |