HOLLY ENERGY PARTNERS LP
Form 10-Q
April 30, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

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

For the transition period from __________ to __________.

Commission File Number: 1-32225

HOLLY ENERGY PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

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

100 Crescent Court, Suite 1600
Dallas, Texas 75201-6915
(Address of principal executive offices)
(214) 871-3555
(Registrant s telephone number, including area code)
None
(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 þ No o

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 o No o

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 definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act).

Yes o No þ

The number of the registrant s outstanding common units at April 23, 2010 was 21,141,009.

HOLLY ENERGY PARTNERS, L.P.
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PART I. FINANCIAL INFORMATION

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, could, b 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. Such 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 in our terminals;
- the economic viability of Holly Corporation, Alon USA, Inc. and our other customers;
- the demand for refined petroleum products in markets we serve;
- our ability to successfully purchase and integrate additional operations in the future;
- 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, operations 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 risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2009 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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Item 1. Financial Statements

Holly Energy Partners, L.P.
Consolidated Balance Sheets

	March 31, 2010 (Unaudited)	December 31, 2009
	(In thousands, except unit data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,609	$ 2,508
Accounts receivable:		
Trade	4,301	4,693
Affiliates	16,155	14,074
	20,456	18,767
Prepaid and other current assets	514	739
Current assets of discontinued operations		2,195
Total current assets	37,579	24,209
Properties and equipment, net	432,057	398,044
Transportation agreements, net	113,699	115,436
Goodwill	49,109	49,109
Investment in SLC Pipeline	26,400	25,919
Other assets	1,845	4,128
Total assets	$ 660,689	$ 616,845
LIABILITIES AND PARTNERS EQUITY		
Current liabilities:		
Accounts payable:		
Trade	$ 3,361	$ 3,860
Affiliates	2,855	2,351
	6,216	6,211
Accrued interest	1,706	2,863
Deferred revenue	9,510	8,402
Accrued property taxes	858	1,072
Other current liabilities	1,148	1,257
Total current liabilities	19,438	19,805
Long-term debt	503,393	390,827
Other long-term liabilities	11,366	12,349

Partners equity:		
Common unitholders (21,141,009 units issued and outstanding)	262,941	275,553
Class B subordinated unitholders (937,500 units issued and outstanding)	21,022	21,426
General partner interest (2% interest)	(146,969)	(93,974)
Accumulated other comprehensive loss	(10,502)	(9,141)
Total partners equity	126,492	193,864
Total liabilities and partners equity	$ 660,689	$ 616,845

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statements of Income
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009
	(In thousands, except per unit data)	
Revenues:		
Affiliates	$ 33,597	$ 18,323
Third parties	7,099	11,009
	40,696	29,332
Operating costs and expenses:		
Operations	13,060	10,342
Depreciation and amortization	7,210	6,016
General and administrative	2,563	1,334
	22,833	17,692
Operating income	17,863	11,640
Other income (expense):		
Equity in earnings of SLC Pipeline	481	175
Interest income	3	6
Interest expense	(7,544)	(5,403)
Other expense	(7)	
SLC Pipeline acquisition costs		(2,500)
	(7,067)	(7,722)
Income from continuing operations before income taxes	10,796	3,918
State income tax	(94)	(73)
Income from continuing operations	10,702	3,845
Income from discontinued operations, net of noncontrolling interest of $495		1,594
Net income	10,702	5,439
Less general partner interest in net income, including incentive distributions	2,646	1,293

Limited partners interest in net income	$	8,056	$	4,146
Limited partners per unit interest in earnings basic and diluted:				
Income from continuing operations	$	0.36	$	0.16
Income from discontinued operations				0.09
Net income	$	0.36	$	0.25
Weighted average limited partners units outstanding		22,079		16,328

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statements of Cash Flows
(Unaudited)

	Three Months Ended March 31, 2010	Three Months Ended March 31, 2009 [1]
	(In thousands)	
Cash flows from operating activities		
Net income	$ 10,702	$ 5,439
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,210	6,256
SLC Pipeline earnings in excess of distributions	(481)	(175)
Change in fair value interest rate swaps	1,464	216
Noncontrolling interest in earnings of Rio Grande Pipeline Company		495
Amortization of restricted and performance units	966	(52)
(Increase) decrease in current assets:		
Accounts receivable trade	392	923
Accounts receivable affiliates	(2,081)	(2,336)
Prepaid and other current assets	225	242
Current assets of discontinued operations	2,195	
Increase (decrease) in current liabilities:		
Accounts payable trade	(499)	(124)
Accounts payable affiliates	504	940
Accrued interest	(1,157)	(1,923)
Deferred revenue	1,108	362
Accrued property taxes	(214)	(335)
Other current liabilities	(109)	(540)
Other, net	(1,502)	168
Net cash provided by operating activities	18,723	9,556
Cash flows from investing activities		
Additions to properties and equipment	(1,911)	(10,570)
Acquisition of assets from Holly Corporation	(37,234)	
Investment in SLC Pipeline		(25,500)
Net cash used for investing activities	(39,145)	(36,070)
Cash flows from financing activities		
Borrowings under credit agreement	33,000	53,000
Repayments under credit agreement	(68,000)	(13,000)
Proceeds from issuance of senior notes	147,540	
Distributions to HEP unitholders	(20,506)	(13,818)
Purchase price in excess of transferred basis in assets acquired from Holly Corporation	(55,766)	
Purchase of units for restricted grants	(1,745)	(616)
Net cash provided by financing activities	34,523	25,566

Cash and cash equivalents		
Increase (decrease) for the period	14,101	(948)
Beginning of period	2,508	5,269
End of period	$ 16,609	$ 4,321

(1) Includes cash flows attributable to discontinued operations.

See accompanying notes.

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Holly Energy Partners, L.P.
Consolidated Statement of Partners Equity
(Unaudited)

	Common Units	Class B Subordinated Units	General Partner Interest	Accumulated Other Comprehensive Loss	Total
			(In thousands)		
Balance December 31, 2009	$ 275,553	$ 21,426	$ (93,974)	$ (9,141)	$ 193,864
Distributions to partners	(19,751)	(755)			(20,506)
Purchase price in excess of transferred basis in assets acquired from Holly Corporation			(55,428)		(55,428)
Purchase of units for restricted grants	(1,745)				(1,745)
Amortization of restricted and performance units	966				966
Comprehensive income:					
Net income	7,918	351	2,433		10,702
Change in fair value of cash flow hedge				(1,361)	(1,361)
Comprehensive income	7,918	351	2,433	(1,361)	9,341
Balance March 31, 2010	$ 262,941	$ 21,022	$ (146,969)	$ (10,502)	$ 126,492

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, currently 34% owned by Holly Corporation and its subsidiaries (collectively Holly). We commenced operations on July 13, 2004 upon the completion of our initial public offering. In these consolidated financial statements, the words we, our, ours and us refer to HEP unless the context otherwise indicates.

We operate in one business segment the operation of petroleum product and crude oil pipelines and terminals, tankage and loading rack facilities.

We own and operate petroleum product and crude oil pipeline and terminal, tankage and loading rack facilities that support Holly s refining and marketing operations in west Texas, New Mexico, Utah, Oklahoma, Idaho and Arizona. We also own and operate refined product pipelines and terminals, located primarily in Texas, that service Alon USA, Inc. s (Alon) refinery in Big Spring, Texas. Additionally, we own a 25% joint venture interest in a 95-mile intrastate crude oil pipeline system (the SLC Pipeline) that serves refineries in the Salt Lake City area.

We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling refined products and other hydrocarbons and storing 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 accounting principles generally accepted in the United States of America 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, 2009. 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, 2010.

Note 2: Discontinued Operations

On December 1, 2009, we sold our 70% interest in Rio Grande Pipeline Company (Rio Grande) to a subsidiary of Enterprise Products Partners LP for $35 million. Accordingly, results of operations of Rio Grande are presented in discontinued operations.

In accounting for the sale, we recorded a gain of $14.5 million and a receivable of $2.2 million, representing our final distribution from Rio Grande. Our recorded net asset balance of Rio Grande at December 1, 2009, was $22.7 million, consisting of cash of $3.1 million, $29.9 million in properties and equipment, net and $10.3 million in equity, representing BP, Plc s 30% noncontrolling interest.

Cash flows from continuing and discontinued operations have been combined for presentation purposes in the Consolidated Statements of Cash Flows. For the three months ended March 31, 2009, net cash flows from our discontinued Rio Grande operations were $2 million.

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Note 3: Acquisitions

2010 Acquisitions

Tulsa East / Lovington Storage Asset Transaction

On March 31, 2010, we acquired from Holly certain storage assets for $88.6 million consisting of hydrocarbon storage tanks having approximately 2 million barrels of storage capacity, a rail loading rack and a truck unloading rack located at Holly s Tulsa refinery east facility.

In connection with this purchase, we amended our 15-year pipeline, tankage and loading rack throughput agreement with Holly (the Holly PTTA) that initially pertained to the logistics and storage assets acquired from an affiliate of Sinclair Oil Company (Sinclair) in December 2009. Under the amended Holly PTTA, Holly has agreed to transport, throughput and load volumes of product through our Tulsa east facility logistics and storage assets that will result in minimum annualized revenues to us of $27.2 million.

Also, as part of this same transaction, we acquired Holly s asphalt loading rack facility located at Holly s Navajo refinery Lovington facility for $4.4 million and entered into 15-year asphalt facility throughput agreement (the Holly ATA). Under the Holly ATA, Holly has agreed to throughput a minimum volume of products via our Lovington asphalt loading rack facility that will result in minimum annualized revenues to us of $0.5 million.

We are a controlled subsidiary of Holly. In accounting for these March 2010 acquisitions from Holly, we recorded total property and equipment at Holly s cost basis of $37.2 million and the purchase price in excess of Holly s basis in the assets of $55.8 million as a decrease to our partners equity.

2009 Acquisitions

Sinclair Logistics and Storage Assets Transaction

On December 1, 2009, we acquired from Sinclair storage tanks having approximately 1.4 million barrels of storage capacity and loading racks at its refinery located in Tulsa, Oklahoma for $79.2 million. The purchase price consisted of $25.7 million in cash, including $4.2 million in taxes and 1,373,609 of our common units having a fair value of $53.5 million. Separately, Holly, also a party to the transaction, acquired Sinclair s Tulsa refinery.

With respect to this purchase, we recorded $30.2 million in properties and equipment, $49.1 million in goodwill and $0.2 million in other long-term liabilities. The value of the acquired assets, which does not include goodwill, is based on management s fair value estimates using a cost approach methodology.

Roadrunner / Beeson Pipelines Transaction

Also on December 1, 2009, we acquired from Holly two newly constructed pipelines for $46.5 million, consisting of a 65-mile, 16-inch crude oil pipeline (the Roadrunner Pipeline) that connects the Navajo refinery facility located in Lovington, New Mexico to a terminus of Centurion Pipeline L.P. s pipeline extending between west Texas and Cushing, Oklahoma and a 37-mile, 8-inch crude oil pipeline that connects our New Mexico crude oil gathering system to the Navajo refinery Lovington facility (the Beeson Pipeline).

Tulsa West Loading Racks Transaction

On August 1, 2009, we acquired from Holly certain truck and rail loading/unloading facilities located at Holly s Tulsa refinery west facility for $17.5 million. The racks load refined products and lube oils produced at the Tulsa refinery onto rail cars and/or tanker trucks.

Lovington-Artesia Pipeline Transaction

On June 1, 2009, we acquired from Holly a newly constructed 16-inch intermediate pipeline for $34.2 million that runs 65 miles from the Navajo refinery s crude oil distillation and vacuum facilities in Lovington, New Mexico to its petroleum refinery located in Artesia, New Mexico.

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The Roadrunner and Beeson Pipelines, loading rack facilities and 16-inch intermediate pipeline discussed above were recorded at $95.1 million, representing Holly s cost basis in the transferred assets. The $3.1 million purchase price in excess of Holly s basis in the assets was recorded as a decrease to our partners equity.

SLC Pipeline Joint Venture Interest

On March 1, 2009, we acquired a 25% joint venture interest in the SLC Pipeline, a new 95-mile intrastate pipeline system that we jointly own with Plains All American Pipeline, L.P. (Plains). The total cost of our investment in the SLC Pipeline was $28 million, consisting of the capitalized $25.5 million joint venture contribution and the $2.5 million finder s fee paid to Holly that was expensed as acquisition costs.

Note 4: 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-tem maturity of these instruments.

Our debt consists of outstanding principal under our revolving credit agreement (the Credit Agreement), our 6.25% senior notes due 2015 (the 6.25% Senior Notes) and our 8.25% senior notes due 2018 (the 8.25% Senior Notes). The $171 million carrying amount of outstanding debt under our Credit Agreement approximates fair value as interest rates are reset frequently using current rates. The estimated fair values of our 6.25% Senior Notes and 8.25% Senior Notes were $175.8 million and $151.5 million, respectively, at March 31, 2010. These fair value estimates are based on market quotes provided from a third-party bank. See Note 8 for additional information on these instruments.

Fair Value Measurements

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.

We have an interest rate swap that is measured at fair value on a recurring basis using Level 2 inputs that as of March 31, 2010 had a fair value of $10.5 million. With respect to this instrument, fair value is based on the net present value of expected future cash flows related to both variable and fixed rate legs of our interest rate swap agreement. Our measurement is computed using the forward London Interbank Offered Rate (LIBOR) yield curve, a market-based observable input. See Note 8 for additional information on our interest rate swap.

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Note 5: Properties and Equipment

	March 31, 2010	December 31, 2009
	(In thousands)	
Pipelines and terminals [1]	$ 492,931	$ 455,075
Land and right of way	25,247	25,230
Other	13,071	12,528
Construction in progress	11,496	10,484
	542,745	503,317
Less accumulated depreciation	110,688	105,273
	$ 432,057	$ 398,044

(1) We periodically evaluate estimated useful lives of our properties and equipment. Effective January 1, 2010, we have revised the estimated useful lives of our terminal assets to 16 to 25 years. This change in estimated useful lives resulted in a $0.7 million reduction in depreciation expense for the three months ended March 31, 2010.

We capitalized $0.1 million and $0.3 million in interest related to major construction projects during the three months ended March 31, 2010 and 2009, respectively.

Note 6: Transportation Agreements

Our transportation agreements consist of the following:

The Alon pipelines and terminals agreement (the Alon PTA) represents a portion of the total purchase price of the Alon assets that was allocated based on an estimated fair value derived under an income approach. This asset is being amortized over 30 years ending 2035, the 15-year initial term of the Alon PTA plus the expected 15-year extension period.

The Holly crude pipelines and tankage agreement (the Holly CPTA) represents a portion of the total purchase price of certain crude pipelines and tankage assets acquired from Holly in 2008 that was allocated using a fair value based on the agreement s expected contribution to our future earnings under an income approach. This asset is being amortized over 15 years ending 2023, the 15-year term of the Holly CPTA.

The carrying amounts of our transportation agreements are as follows:

	March 31, 2010	December 31, 2009
	(In thousands)	
Alon transportation agreement	$ 59,933	$ 59,933
Holly crude pipelines and tankage agreement	74,231	74,231
	134,164	134,164
Less accumulated amortization	20,465	18,728
	$ 113,699	$ 115,436

We have additional transportation agreements with Holly that relate to pipeline, terminal and tankage assets contributed to us or acquired from Holly. These transfers occurred while under common control of Holly, therefore, our basis in these assets reflect Holly s historical cost and does not reflect a step-up in basis to fair value. These agreements have a recorded value of zero.

In addition, we have an agreement to provide transportation and storage servic