HOLLY ENERGY PARTNERS LP
Form 10-Q
October 30, 2009

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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 September 30, 2009

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 (Do not check if a smaller reporting company)	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 October 23, 2009 was 17,582,400.

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. These statements are based on management s beliefs and assumptions 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 believe that the expectations reflected in these forward-looking statements are reasonable, we cannot assure you that our expectations will prove correct. Therefore, actual outcomes and results could differ materially from what is expressed, implied or forecast in these statements. Any differences could be caused by a number of factors, including, but 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 pending 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, 2008 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

	September 30, 2009 (Unaudited)	December 31, 2008
	(In thousands, except unit data)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,050	$ 5,269
Accounts receivable:		
Trade	4,965	5,082
Affiliates	11,176	9,395
	16,141	14,477
Prepaid and other current assets	1,070	593
Total current assets	21,261	20,339
Properties and equipment, net	349,062	290,284
Transportation agreements, net	117,173	122,383
Investment in SLC Pipeline	26,809	
Other assets	4,660	6,682
Total assets	$ 518,965	$ 439,688
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable:		
Trade	$ 3,001	$ 5,816
Affiliates	1,965	2,202
	4,966	8,018
Accrued interest	916	2,845
Deferred revenue	7,582	15,658
Accrued property taxes	1,486	1,145
Other current liabilities	1,368	1,505
Short-term borrowings under credit agreement		29,000
Total current liabilities	16,318	58,171
Long-term debt	429,819	355,793
Other long-term liabilities	13,759	17,604

Equity:		
Holly Energy Partners, L.P. partners equity (deficit):		
Common unitholders (17,582,400 and 8,390,000 units issued and outstanding at September 30, 2009 and December 31, 2008, respectively)	136,746	169,126
Subordinated unitholders (7,000,000 units issued and outstanding at December 31, 2008)		(85,059)
Class B subordinated unitholders (937,500 units issued and outstanding at September 30, 2009 and December 31, 2008)	21,054	21,455
General partner interest (2% interest)	(99,359)	(94,653)
Accumulated other comprehensive loss	(10,181)	(12,967)
Total Holly Energy Partners, L.P. partners equity (deficit)	48,260	(2,098)
Noncontrolling interest	10,809	10,218
Total equity	59,069	8,120
Total liabilities and equity	$ 518,965	$ 439,688

See accompanying notes.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2009	2008	2009	2008
	(In thousands, except per unit data)			
Revenues:				
Affiliates	$ 28,359	$ 22,737	$ 71,746	$ 61,210
Third parties	14,385	6,774	43,724	22,352
	42,744	29,511	115,470	83,562
Operating costs and expenses:				
Operations	11,450	11,033	33,332	30,745
Depreciation and amortization	6,820	5,884	19,929	16,259
General and administrative	1,848	1,596	4,990	4,241
	20,118	18,513	58,251	51,245
Operating income	22,626	10,998	57,219	32,317
Other income (expense):				
Equity in earnings of SLC Pipeline	711		1,309	
SLC Pipeline acquisition costs			(2,500)	
Interest income	2	25	10	146
Interest expense	(6,418)	(5,161)	(16,225)	(14,201)
Other		1,007	65	1,043
	(5,705)	(4,129)	(17,341)	(13,012)
Income before income taxes	16,921	6,869	39,878	19,305
State income tax	(113)	(84)	(317)	(237)
Net income	16,808	6,785	39,561	19,068
Less noncontrolling interest in net income	269	164	1,191	834
Net income attributable to Holly Energy Partners, L.P.	$ 16,539	$ 6,621	$ 38,370	$ 18,234

Less general partner interest in net income attributable to Holly Energy Partners, L.P.	2,022	1,008	5,163	2,736
Limited partners interest in net income attributable to Holly Energy Partners, L.P.	$ 14,517	$ 5,613	$ 33,207	$ 15,498
Limited partners per unit interest in net income attributable to Holly Energy Partners, L.P. basic and diluted	$ 0.78	$ 0.34	$ 1.89	$ 0.95
Weighted average limited partners units outstanding	18,520	16,328	17,546	16,279

See accompanying notes.

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

	Nine Months Ended September 30, 2009	Nine Months Ended September 30, 2008
	(In thousands)	
Cash flows from operating activities		
Net income	$ 39,561	$ 19,068
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,929	16,259
Equity in earnings of SLC Pipeline	(1,309)	
Change in fair value interest rate swaps	300	
Amortization of restricted and performance units	631	1,194
Gain on sale of assets		(36)
(Increase) decrease in current assets:		
Accounts receivable trade	117	(892)
Accounts receivable affiliates	(1,781)	(3,388)
Prepaid and other current assets	(477)	(312)
Increase (decrease) in current liabilities:		
Accounts payable trade	(2,815)	(52)
Accounts payable affiliates	(237)	(3,684)
Accrued interest	(1,929)	(1,985)
Deferred revenue	(8,076)	10,638
Accrued property taxes	341	200
Other current liabilities	(137)	278
Other, net	670	802
Net cash provided by operating activities	44,788	38,090
Cash flows from investing activities		
Additions to properties and equipment	(27,478)	(29,024)
Acquisition of 16-inch intermediate pipeline	(34,200)	
Investment in SLC Pipeline	(25,500)	
Acquisition of Tulsa loading racks	(11,800)	
Acquisition of crude pipelines and tankage assets		(171,000)
Proceeds from sale of assets		36
Net cash used for investing activities	(98,978)	(199,988)
Cash flows from financing activities		
Borrowings under credit agreement	197,000	221,000
Repayments under credit agreement	(152,000)	(26,000)
Proceeds from issuance of common units	58,355	104
Capital contribution from general partner	1,191	186
Distributions to HEP unitholders	(44,393)	(38,908)
Purchase price in excess of transferred basis in Tulsa loading racks	(5,700)	
Distributions to noncontrolling interest	(600)	(1,200)

Cost of issuing common units	(266)	
Purchase of units for restricted grants	(616)	(795)
Deferred financing costs		(692)
Net cash provided by financing activities	52,971	153,695
Cash and cash equivalents		
Decrease for period	(1,219)	(8,203)
Beginning of period	5,269	10,321
End of period	$ 4,050	$ 2,118

See accompanying notes.

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

	Holly Energy Partners, L.P. Partners Equity (Deficit):						
	Common Units	Subordinated Units	Class B Subordinated Units	General Partner Interest	Accumulated Other Comprehensive Loss	Non-Controlling Interest	Total
				(In thousands)			
Balance December 31, 2008	$ 169,126	$ (85,059)	$ 21,455	$ (94,653)	$ (12,967)	$ 10,218	$ 8,120
Issuance of common units in public offering	58,355						58,355
Conversion of subordinated units	(90,824)	90,824					
Cost of issuing common units	(266)						(266)
Capital contribution				1,191			1,191
Distributions HEP unitholders	(21,253)	(16,275)	(2,180)	(4,685)			(44,393)
Distributions noncontrolling interest						(600)	(600)
Purchase price in excess of transferred basis in Tulsa loading racks				(5,700)			(5,700)
Purchase of units for restricted grants	(616)						(616)
Amortization of restricted and performance units	631						631
Comprehensive income:							
Net income	21,593	10,510	1,779	4,488		1,191	39,561
Change in fair value of cash flow hedge					2,786		2,786
Comprehensive income	21,593	10,510	1,779	4,488	2,786	1,191	42,347
Balance September 30, 2009	$ 136,746	$	$ 21,054	$ (99,359)	$ (10,181)	$ 10,809	$ 59,069

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 41% owned by Holly Corporation and its subsidiaries (collectively Holly). We commenced operations July 13, 2004 upon the completion of our initial public offering. In this document, 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.

One of Holly s wholly-owned subsidiaries owns a refinery in Artesia, New Mexico, which Holly operates in conjunction with crude, vacuum distillation and other facilities situated in Lovington, New Mexico (collectively, the Navajo Refinery). The Navajo Refinery produces high-value refined products such as gasoline, diesel fuel and jet fuel and serves markets in the southwestern United States and northern Mexico. We own and operate intermediate feedstock pipelines (the Intermediate Pipelines), which connect the New Mexico refining facilities. Our operations serving the Navajo Refinery include refined product pipelines that serve as part of the refinery s product distribution network. We also own and operate crude oil pipelines and on-site crude oil tankage that supply and support the refinery. Our terminal operations serving the Navajo Refinery include an on-site truck rack at the refinery and five integrated refined product terminals located in New Mexico, Texas and Arizona.

Another of Holly s wholly-owned subsidiaries owns a refinery located near Salt Lake City, Utah (the Woods Cross Refinery). Our operations serving the Woods Cross Refinery include crude oil and refined product pipelines, crude oil tankage and a truck rack at the refinery, a refined product terminal in Spokane, Washington and a 50% non-operating interest in product terminals in Boise and Burley, Idaho.

In June 2009, Holly acquired a petroleum refinery, including supporting infrastructure, located in Tulsa, Oklahoma (the Tulsa Refinery). On August 1, 2009, we acquired from Holly certain on-site truck and rail loading/unloading facilities that service the Tulsa Refinery. See Note 2 for additional information on this transaction.

We also own and operate refined products pipelines and terminals, located primarily in Texas, that service Alon USA, Inc. s (Alon) refinery in Big Spring, Texas.

Additionally, we own a refined product terminal in Mountain Home, Idaho, and a 70% interest in Rio Grande Pipeline Company (Rio Grande), which provides transportation of liquefied petroleum gases to northern Mexico.

In March 2009, we acquired a 25% joint venture interest in a new 95-mile intrastate pipeline system (the SLC Pipeline) jointly owned by Plains All American Pipeline, L.P. (Plains) and us. See Note 2 for additional information on the SLC Pipeline joint venture.

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, 2008. 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, 2009.

These consolidated financial statements reflect management s evaluation of subsequent events through the time of our filing of this quarterly report on October 30, 2009.

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Recent Accounting Pronouncements

Accounting Standards Codification

In June 2009, the Financial Accounting Standards Board (FASB) issued its Accounting Standards Codification (ASC), codifying all previous sources of accounting principles into a single source of authoritative, nongovernmental U.S. generally accepted accounting principles (U.S. GAAP). Although the ASC supersedes all previous levels of authoritative accounting standards, it did not affect accounting principles under U.S. GAAP. We adopted the codification effective September 30, 2009.

Subsequent Events

In May 2009, the FASB issued accounting standards under ASC Topic Subsequent Events (previously Statement of Financial Accounting Standard (SFAS) No. 165) which establish general standards for accounting and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. We adopted these standards effective June 30, 2009. Although these standards require disclosure of the date through which we have evaluated subsequent events, it did not affect our accounting and disclosure policies with respect to subsequent events.

Interim Disclosures about Fair Value of Financial Instruments

In April 2009, the FASB issued accounting standards under ASC Topic Financial Instruments (previously FASB Staff Position (FSP) SFAS No. 107-1 and Accounting Principles Board (APB) Opinion No. 28-1) which extend the annual financial statement disclosure requirements for financial instruments to interim reporting periods of publicly traded companies. We adopted these standards effective June 30, 2009. See Note 3 for disclosure of our financial instruments.

Noncontrolling Interests in Consolidated Financial Statements

Accounting standards under ASC Topic Noncontrolling Interest in a Subsidiary (previously SFAS No. 160) became effective January 1, 2009, which change the classification of noncontrolling interests, also referred to as minority interests, in the consolidated financial statements. As a result, all previous references to minority interest within this document have been replaced with noncontrolling interest. Additionally, net income attributable to the noncontrolling interest in our Rio Grande subsidiary is now presented as an adjustment to net income to arrive at Net income attributable to Holly Energy Partners, L.P. in our Consolidated Statements of Income. Prior to our adoption of these standards, this amount was presented as Minority interest in Rio Grande, a non-operating expense item before Income before income taxes. Furthermore, equity attributable to noncontrolling interests in our Rio Grande subsidiary is now presented as a separate component of total equity in our Consolidated Financial Statements. We have applied these standards on a retrospective basis. While this presentation differs from previous U.S. GAAP requirements, it did not affect our net income and equity attributable to HEP.

Business Combinations

Accounting standards under ASC Topic Business Combinations (previously SFAS 141 No. (R)) became effective January 1, 2009, which establish principles and requirements for how an acquirer accounts for a business combination. It also requires that acquisition-related transaction and restructuring costs be expensed rather than be capitalized as part of the cost of an acquired business. Accordingly, we were required to expense the $2.5 million finder s fee related to the acquisition of our SLC Pipeline joint venture interest.

Disclosures about Derivative Instruments and Hedging Activities

Accounting standards under ASC Topic Derivatives and Hedging (previously SFAS No. 161) became effective January 1, 2009, which amend and expand disclosure requirements to include disclosure of the objectives and strategies related to an entity s use of derivative instruments, disclosure of how an entity accounts for its derivative instruments and disclosure of the financial impact, including the effect on cash flows associated with derivative activity. See Note 7 for disclosure of our derivative instruments and hedging activity.

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Earnings per Share Master Limited Partnerships

Accounting standards under ASC Topic Earnings Per Share (previously Emerging Issues Task Force (EITF) Issue No. 07-04) became effective January 1, 2009, which prescribe the application of the two-class method in computing earnings per unit to reflect a master limited partnership s contractual obligation to make distributions to the general partner, limited partners and incentive distribution rights holders. As a result, quarterly earnings allocations to the general partner now include incentive distributions that were declared subsequent to quarter end. Prior to our adoption of these standards, our general partner earnings allocations included incentive distributions that were declared during each quarter. We have applied these standards on a retrospective basis. The adoption of these standards resulted in a decrease in our limited partners interest in net income attributable to Holly Energy Partners, L.P. for the three and nine months ended September 30, 2008, reducing earnings per limited partner unit by $.01 to $0.34 and $0.95 for the three and nine months ended September 30, 2008, respectively.

Participating Securities Instruments Granted in Share-Based Tr