



Holly Energy Partners (HEP)

Updated November 14th, 2022 by Aristofanis Papadatos

Key Metrics

Current Price:	\$19	5 Year CAGR Estimate:	12.5%	Market Cap:	\$2.4 B
Fair Value Price:	\$24	5 Year Growth Estimate:	2.0%	Ex-Dividend Date:	1/30/2023 ¹
% Fair Value:	80%	5 Year Valuation Multiple Estimate:	4.7%	Dividend Payment Date:	2/10/2023
Dividend Yield:	7.4%	5 Year Price Target	\$26	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	B	Rating:	Buy

Overview & Current Events

As a midstream Master Limited Partnership, or MLP, Holly Energy Partners (HEP) is responsible for transporting and storing crude oil and refined products. The company operates its own crude oil and petroleum pipelines and storage terminals in ten U.S. states, including Texas, Nevada and Washington. HEP also has refinery facilities in Utah and Kansas. HEP was founded in 2004 by HF Sinclair (DINO) and generates revenue by charging customers a fee for transporting and storing petroleum products. With a market capitalization of just \$2.4 billion, HEP is smaller than many of its peers.

Nearly all the revenues of HEP are fee-based. Thus, these revenues are hardly affected by prevailing commodity prices. Instead, they are proportional to the volumes transported and stored by the MLP. These volumes are reliable because they are determined by long-term contracts, which pose strict minimums to the customers of the MLP. As a result, in the downturn of the oil market during 2014-2017, while other MLPs saw their earnings collapse, HEP grew its earnings-per-share and its distributable cash flow per share by 76% and 52%, respectively.

On March 14th, 2022, HEP completed the acquisition of the pipelines and terminal assets of Sinclair Transportation. The deal included 1,200 miles of pipelines of crude oil and products, 8 product terminals and 2 crude terminals. HEP paid \$325 million and issued 21 million of common units to pay for the deal, which was valued at \$758 million.

In early November, HEP reported (11/7/22) financial results for the third quarter of fiscal 2022. Distributable cash flow (DCF) grew 18% over last year's quarter thanks to higher volumes, which resulted from the acquisition of Sinclair Transportation, partly offset by increased interest expense due to the acquisition. Due to the pandemic, HEP cut its quarterly distribution by -48% in 2020, from \$0.69 to \$0.35, after 60 consecutive quarters without a cut. However, HEP has recovered strongly from the pandemic, with its current volumes exceeding pre-COVID levels. HEP expects sustained business momentum going forward and currently has a healthy distribution coverage ratio of 1.8.

Growth on a Per-Share Basis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
DCFPS²	\$2.17	\$2.00	\$2.27	\$3.66	\$3.52	\$3.46	\$2.53	\$2.58	\$2.69	\$2.56	\$2.65	\$2.93
EPS	\$1.27	\$0.88	\$1.20	\$1.60	\$1.69	\$2.11	\$1.70	\$2.13	\$1.61	\$2.03	\$1.80	\$2.20
DPS	\$1.84	\$1.96	\$2.08	\$2.20	\$2.32	\$2.51	\$2.63	\$2.68	\$1.72	\$1.40	\$1.40	\$1.70
Shares³	55.7	58.0	59.0	59.0	60.0	70.3	104.9	105.4	105.4	105.4	126.4	150.0

HEP achieves growth thanks to contractual tariff escalators, which raise the fees it charges to its customers over time, and the addition of new pipelines. HEP has more than 800 miles of crude oil gathering facilities in the Permian Basin and can continue leveraging its footprint in this area for years.

HEP will be hurt by the conversion of HF Sinclair's Cheyenne refinery to a renewable diesel plant due to the resultant steep decrease in volumes. However, the acquisition of Sinclair Transportation will probably be a growth driver.

Moreover, HEP is one of the most resilient MLPs thanks to its robust business model. About 80% of its minimum-volume

¹ Estimated date.

² DCFPS stands for Distributable Cash Flow Per Share

³ In millions.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



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contracts with its customers expire after 2024 and the average duration of its contracts with HF Sinclair is 10-15 years. Overall, we expect HEP to grow its DCFPS by at least 2.0% per year on average over the next five years.

Valuation Analysis

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Now	2027
P/DCF	14.2	18.1	14.8	8.8	9.1	9.8	11.8	10.3	5.7	7.3	7.2	9.0
Avg. Yld.	6.0%	5.4%	6.2%	6.8%	7.2%	7.7%	8.8%	10.1%	11.2%	7.5%	7.4%	6.5%

HEP is currently trading at a price-to-cash flow ratio of 7.2, which is much lower than its 10-year average of 11.0. We assume a fair cash flow multiple of 9.0, which is the 5-year average of the stock. If the stock approaches our fair value estimate over the next five years, it will enjoy a 4.7% annualized gain thanks to the expansion of its valuation level.

Safety, Quality, Competitive Advantage, & Recession Resiliency

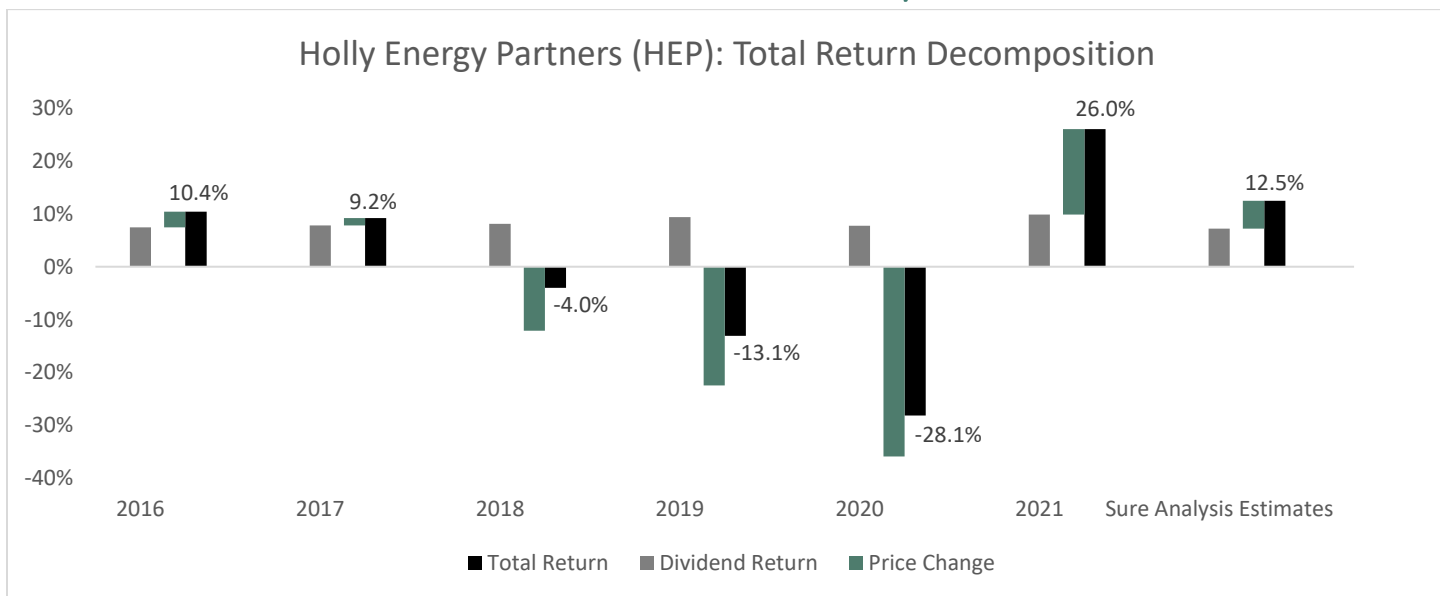
Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2027
Payout ⁴	84.8%	98%	91.6%	60.1%	65.9%	72.5%	104%	104%	63.9%	54.7%	52.8%	58.2%

HEP raised its distribution for 60 consecutive quarters since its IPO in 2004. This is an impressive record, particularly given that the period includes the Great Recession and the downturn of the oil market in 2014-2017. This is a testament to the strength of its business model, execution and discipline to invest only in high-return growth projects. However, HEP cut its distribution proactively in 2020 due to the pandemic but it is still offering an attractive 7.4% yield, with strong distribution coverage. Management has hinted that it intends to keep the distribution constant next year. Overall, this MLP is exceptionally attractive for income-oriented investors.

Final Thoughts & Recommendation

HEP has a markedly resilient business model. We expect it to offer a 12.5% average annual return over the next five years thanks to its 7.4% distribution, 2.0% growth of DCF and a 4.7% valuation tailwind. We rate the stock as a buy, though patience may be required for valuation to revert to normal levels.

Total Return Breakdown by Year



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⁴ Payout ratio is calculated by dividing DPS by DCFPS.

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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue	293	305	333	359	402	454	506	533	498	494
Gross Profit	146	140	164	190	208	237	261	274	251	230
Gross Margin	49.9%	46.0%	49.3%	52.9%	51.6%	52.3%	51.6%	51.4%	50.3%	46.5%
SG&A Exp.	8	12	11	13	13	14	11	10	10	13
D&A Exp.	57	65	63	63	70	79	98	97	100	94
Operating Profit	138	129	153	177	195	223	250	264	241	218
Operating Margin	47.3%	42.1%	46.0%	49.4%	48.5%	49.1%	49.4%	49.5%	48.3%	44.0%
Net Profit	90	79	104	135	148	195	179	225	170	215
Net Margin	30.7%	26.0%	31.2%	37.5%	36.7%	42.9%	35.3%	42.2%	34.2%	43.5%
Free Cash Flow	118	126	-13	38	184	194	248	267	256	204
Income Tax	0	0	0	0	0	0	0	0	0	0

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	1,394	1,383	1,439	1,778	1,884	2,154	2,103	2,199	2,168	2,166
Cash & Equivalents	5	6	3	15	4	8	3	13	22	14
Accounts Receivable	7	5	7	9	8	13	12	19	15	13
Goodwill & Int. Ass.	351	344	337	330	323	396	386	372	322	297
Total Liabilities	941	916	989	1,151	1,412	1,669	1,587	1,711	1,662	1,575
Accounts Payable	7	14	16	11	11	15	16	18	28	29
Long-Term Debt	865	808	867	1,009	1,244	1,507	1,419	1,462	1,406	1,333
Shareholder's Equity	353	369	355	532	378	394	427	381	379	443

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	6.4%	5.7%	7.4%	8.4%	8.1%	9.7%	8.4%	10.5%	7.8%	9.9%
Return on Equity	18.1%	22.0%	28.7%	30.3%	32.4%	50.5%	43.5%	55.6%	44.8%	52.3%
Shares Out.	55.7	58.0	59.0	59.0	60.0	70.3	104.9	105.4	105.4	105.4
Revenue/Share	5.25	5.24	5.67	6.12	6.72	6.46	4.82	5.05	4.72	4.69
FCF/Share	2.12	2.17	-0.23	0.65	3.07	2.76	2.36	2.53	2.43	1.94

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

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