

HOLLY ENERGY PARTNERS LP
Form 10-Q
November 02, 2012

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2012

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

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.)

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 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 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 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

The number of the registrant's outstanding common units at October 26, 2012 was 28,391,024.

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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,” “could,” “believe,” 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, 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 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, 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, 2011 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)

	September 30, 2012	December 31, 2011 ⁽¹⁾
	(In thousands, except unit data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$1,993	\$6,369
Accounts receivable:		
Trade	6,527	6,130
Affiliates	36,305	31,922
	42,832	38,052
Prepaid and other current assets	4,313	3,729
Total current assets	49,138	48,150
Properties and equipment, net	943,604	954,864
Transportation agreements, net	96,333	101,543
Goodwill	256,498	256,498
Investment in SLC Pipeline	25,179	25,302
Other assets	9,021	7,204
Total assets	\$1,379,773	\$1,393,561
LIABILITIES AND PARTNERS' EQUITY		
Current liabilities:		
Accounts payable:		
Trade	\$5,662	\$18,375
Affiliates	5,641	6,474
	11,303	24,849
Accrued interest	2,506	8,280
Deferred revenue	9,280	4,032
Accrued property taxes	5,040	2,196
Other current liabilities	2,489	1,777
Total current liabilities	30,618	41,134
Long-term debt	874,434	605,888
Other long-term liabilities	7,574	4,000
Class B unit	12,414	—
Equity:		
Partners' equity:		
Common unitholders (28,391,024 and 27,361,124 units issued and outstanding at September 30, 2012 and December 31, 2011, respectively)	505,293	482,509

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General partner interest (2% interest)	(144,555) 167,492	
Accumulated other comprehensive loss	(5,886) (6,464)
Total partners' equity	354,852	643,537	
Noncontrolling interest	99,881	99,002	
Total equity	454,733	742,539	
Total liabilities and equity	\$1,379,773	\$1,393,561	

(1) Recast as described in Note 2.

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,	
	2012	2011 ⁽¹⁾	2012	2011 ⁽¹⁾
	(In thousands, except per unit data)			
Revenues:				
Affiliates	\$60,576	\$40,714	\$172,341	\$111,874
Third parties	11,920	8,322	34,648	33,035
	72,496	49,036	206,989	144,909
Operating costs and expenses:				
Operations	21,324	16,398	61,355	43,804
Depreciation and amortization	13,044	8,916	39,899	24,627
General and administrative	1,399	2,012	5,925	4,948
	35,767	27,326	107,179	73,379
Operating income	36,729	21,710	99,810	71,530
Other income (expense):				
Equity in earnings of SLC Pipeline	877	641	2,502	1,848
Interest expense	(12,540)	(8,828)	(34,269)	(26,101)
Loss on early extinguishment of debt	—	—	(2,979)	—
Other (income) expense	—	20	—	8
	(11,663)	(8,167)	(34,746)	(24,245)
Income before income taxes	25,066	13,543	65,064	47,285
State income tax (expense) benefit	(137)	77	(287)	(169)
Net income	24,929	13,620	64,777	47,116
Allocation of net loss attributable to Predecessors	146	3,000	4,199	3,515
Allocation of net loss (income) attributable to noncontrolling interests	(582)	124	658	295
Net income attributable to Holly Energy Partners	24,493	16,744	69,634	50,926
General partner interest in net income, including incentive distributions	(5,299)	(4,009)	(16,724)	(11,418)
Limited partners' interest in net income	\$19,194	\$12,735	\$52,910	\$39,508
Limited partners' per unit interest in earnings—basic and diluted	\$0.68	\$0.58	\$1.91	\$1.79
Weighted average limited partners' units outstanding	28,268	22,079	27,666	22,079

⁽¹⁾ Recast as described in Note 2.

See accompanying notes.

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

	Three Months Ended September 30, 2012		2011 ⁽¹⁾		Nine Months Ended September 30, 2012		2011 ⁽¹⁾	
	(In thousands)							
Net income	\$24,929	\$13,620	\$64,777	\$47,116				
Allocation of net loss attributable to Predecessors	146	3,000	4,199	3,515				
Net income before noncontrolling interests	25,075	16,620	68,976	50,631				
Other comprehensive income (loss):								
Change in fair value of cash flow hedge	(1,381	) 1,094	(3,243	) 2,648				
Amortization of unrealized loss attributable to discontinued cash flow hedge	1,274	—	3,821	—				
Other comprehensive income (loss)	(107	) 1,094	578	2,648				
Comprehensive income before noncontrolling interest	24,968	17,714	69,554	53,279				
Allocation of comprehensive (income) loss to noncontrolling interests	(582	) 124	658	295				
Comprehensive income	\$24,386	\$17,838	\$70,212	\$53,574				

⁽¹⁾ Recast as described in Note 2.

See accompanying notes.

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

	Nine Months Ended September 30,	
	2012	2011 ⁽¹⁾
	(In thousands)	
Cash flows from operating activities		
Net income	\$64,777	\$47,116
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	39,899	24,627
Equity in earnings of SLC Pipeline, net of distributions	123	89
Amortization of restricted and performance units	2,233	1,634
(Increase) decrease in current assets:		
Accounts receivable—trade	(3,397	) (561
Accounts receivable—affiliates	(1,240	) (750
Prepaid and other current assets	(584	) (870
Increase (decrease) in current liabilities:		
Accounts payable—trade	(7,097	) 3,326
Accounts payable—affiliates	(833	) (496
Accrued interest	(5,774	) (5,977
Deferred revenue	5,248	(3,917
Accrued property taxes	2,845	810
Other current liabilities	711	(124
Other, net	6,416	2,482
Net cash provided by operating activities	103,327	67,389
Cash flows from investing activities		
Additions to properties and equipment	(32,087	) (149,885
Net cash used for investing activities	(32,087	) (149,885
Cash flows from financing activities		
Borrowings under credit agreement	523,000	93,000
Repayments of credit agreement borrowings	(292,000	) (50,000
Proceeds from issuance of senior notes	294,750	—
Cash distribution to HFC for UNEV Acquisition	(260,922) —
Repayment of promissory notes	(257,900) —
Contributions from UNEV joint venture partners	16,748	123,500
Distributions to HEP unitholders	(91,063	) (67,963
Purchase of units for incentive grants	(4,919	) (1,641
Deferred financing costs	(3,222	) (3,150
Other	(88) —
Net cash provided (used) by financing activities	(75,616	) 93,746
Cash and cash equivalents		
Increase (decrease) for the period	(4,376	) 11,250
Beginning of period	6,369	8,052

End of period	\$ 1,993	\$ 19,302
(1) Recast as described in Note 2.		

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, 2011 ⁽¹⁾	\$482,509	\$167,492	\$(6,464)	\$99,002	\$742,539
Net income	52,909	18,188	—	(2,121)	68,976
Net loss - Predecessor	—	(4,199)	—	—	(4,199)
Other comprehensive income	—	—	578	—	578
Capital contribution	—	10,286	—	3,000	13,286
Distributions to HEP unitholders	(73,596)	(17,467)	—	—	(91,063)
Purchase of 75% interest in UNEV Pipeline from HollyFrontier:					
Cash distributions	—	(260,922)	—	—	(260,922)
Issuance of common units	45,839	(45,839)	—	—	—
Issuance of Class B unit	—	(12,200)	—	—	(12,200)
Purchase of units for restricted grants	(4,392)	—	—	—	(4,392)
Amortization of restricted and performance units	2,233	—	—	—	2,233
Class B unit accretion	(209)	(4)	—	—	(213)
Other	—	110	—	—	110
Balance September 30, 2012	\$505,293	\$(144,555)	\$(5,886)	\$99,881	\$454,733

⁽¹⁾ Recast as described in Note 2.

See accompanying notes.

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UNEV Pipeline percentage acquired	75	%
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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 44% 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 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.

On July 12, 2012, we acquired a 75% interest in UNEV Pipeline, LLC (“UNEV”), which owns a recently constructed 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. We have retrospectively adjusted our historical financial position, results of operations, cash flows and statements of partners' equity for all periods to include UNEV for the periods we were under common control of HFC. Results of operations of UNEV prior to the acquisition on July 12, 2012 are herein referred to as the results of operations attributable to the previous owner (“Predecessor”). Additionally, Predecessor equity prior to the acquisition is included in general partner equity on the balance sheet due to the common control ownership. See Note 2 below for additional information on this acquisition.

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, 2011. 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, 2012.

On November 9, 2011, we acquired from HFC certain tankage, loading rack and crude oil receiving assets located at HFC's El Dorado and Cheyenne refineries. See Note 2 below for additional information on this acquisition. We accounted for this transaction as a business combination between entities under common control and were required to retrospectively adjust the operating results as if we had acquired such assets on July 1, 2011 (the date HFC acquired the assets). Although these assets did not generate revenues prior to November 9, 2011, our operating results included \$3.8 million of operating costs and depreciation incurred by HFC prior to the acquisition date. We have revised limited partners' interest in net income and limited partners' per unit interest in earnings - basic and diluted from continuing operations from amounts originally reported in our historical financial statements

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

included in the Form 10-K for the year ended December 31, 2011. This loss was allocated in the originally reported amounts principally to the limited partners. As the pre-acquisition loss was not attributable to HEP, but rather to the Predecessor, the pre-acquisition loss should have been reported as a loss attributable to the Predecessor. Limited partners' interest in net income was originally reported at \$61.2 million or \$2.68 per basic and diluted unit. This revision in the classification of the Predecessor's loss increased limited partners' interest in net income to \$64.9 million or \$2.84 per basic and diluted unit from continuing operations. This change had no impact on the reported net income or distributable cash flow.

Additionally, originally reported limited partners' interest in net income and per unit interest in net income for the third and fourth quarters of 2011 of \$10.2 million and \$0.46 and \$24.3 million and \$0.97, respectively, as reported in Note 14 of the 2011 consolidated financial statements have been adjusted to \$12.7 million and \$0.58 and \$25.4 million and \$1.01, respectively. This change had no impact on the reported net income or distributable cash flow.

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 1,029,900 of our common units. We paid an additional \$0.9 million to HFC for a post-closing working capital adjustment as provided for by the acquisition agreement. As a result of the common units issued to HFC, HFC's ownership interest in us increased from 42% to 44% (including the 2% general partner interest). 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 an 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 the next twelve consecutive quarterly periods and up to an additional four quarters in certain circumstances. The Class B unit has an initial value of \$12.2 million which will increase 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.

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 and the nine months ended September 30, 2012, our consolidated statement of income includes revenues from UNEV of \$3.0 million and \$10.8 million, respectively, and net losses of \$3.5 million and \$8.5 million, respectively. Predecessor revenues are \$0.3 million and \$8.1 million, respectively, and Predecessor net losses are \$0.1 million and \$4.2 million, respectively. For the three and the nine months ended September 30, 2011, there were no Predecessor revenues as UNEV was not yet operational. Predecessor net losses were \$0.4 million and \$0.9 million, respectively, for the three and the nine months ended September 30, 2011. At September 30, 2012, UNEV had transportation agreements with shippers that provide minimum annualized revenues of \$25.0 million, of which \$16.9 million relates to a transportation agreement with HFC.

The following table provides HFC's carrying basis related to UNEV on July 12, 2012, immediately prior to the acquisition, and at December 31, 2011.

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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.

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

(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 at September 30, 2012 and December 31, 2011 were as follows:

Financial Instrument	Fair Value Input Level	September 30, 2012		December 31, 2011	
		Carrying Value (In thousands)	Fair Value	Carrying Value	Fair Value
Liabilities:					
Senior notes:					
6.25% senior notes	Level 2	\$—	\$—	\$184,895	\$186,850
6.5% senior notes	Level 2	295,112	311,250	—	—
8.25% senior notes	Level 2	148,322	162,375	148,093	157,500
		443,434	473,625	332,988	344,350
Interest rate swaps	Level 2	3,764	3,764	520	520
		\$447,198	\$477,389	\$333,508	\$344,870

Level 2 Financial Instruments

Our senior notes and interest rate swaps are measured and recorded at fair value using Level 2 inputs. The fair value of the senior notes is based on market values provided by a third-party bank, which were derived using market quotes for similar type debt instruments. With respect to our interest rate swaps, the fair value is based on the net present value of expected future cash flows related to both variable and fixed rate legs of the swap agreement. This measurement is computed using the forward London Interbank Offered Rate (“LIBOR”) yield curve, a market-based observable input.

See Note 7 for additional information on these instruments.

Note 4: Properties and Equipment

The carrying amounts of our properties and equipment are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Pipelines and terminals	\$1,023,811	\$879,670
Land and right of way	62,627	43,904
Construction in progress	28,399	172,072
Other	18,815	17,554
	1,133,652	1,113,200
Less accumulated depreciation	190,048	158,336
	\$943,604	\$954,864

We capitalized \$0.2 million and \$0.8 million in interest related to construction projects during the nine months ended September 30, 2012 and 2011, respectively.

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

Note 5: Transportation Agreements

Our transportation agreements represent a portion of the total purchase price of certain assets acquired from Alon in 2005 and from HFC in 2008. The Alon agreement is being amortized over 30 years ending 2035 (the initial 15-year term of the agreement plus an expected 15-year extension period) and the HFC agreement is being amortized over 15 years ending 2023 (the term of the HFC agreement).

The carrying amounts of our transportation agreements are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Alon transportation agreement	\$59,933	\$59,933
HFC transportation agreement	74,231	74,231
	134,164	134,164
Less accumulated amortization	37,831	32,621
	\$96,333	\$101,543

We have additional transportation agreements with HFC that relate to assets contributed to us or acquired from HFC consisting of pipeline, terminal and tankage assets. These transactions occurred while we were a consolidated variable interest entity of HFC, therefore, our basis in these agreements is zero and does not reflect a step-up in basis to fair value.

Note 6: Employees, Retirement and Incentive Plans

Employees who provide direct services to us are employed by Holly Logistic Services, L.L.C., an HFC subsidiary. Their costs, including salaries, bonuses, payroll taxes, benefits and other direct costs, are charged to us monthly in accordance with an omnibus agreement that we have with HFC. These employees participate in the retirement and benefit plans of HFC. Our share of retirement and benefit plan costs was \$1.6 million and \$0.8 million for the three months ended September 30, 2012 and 2011, respectively, and \$4.7 million and \$2.2 million for the nine months ended September 30, 2012 and 2011, respectively.

We have an incentive plan ("Long-Term Incentive Plan") for employees, consultants and non-employee directors who perform services for us. The Long-Term Incentive Plan consists of four components: restricted units, performance units, unit options and unit appreciation rights.

As of September 30, 2012, we have two types of incentive-based awards which are described below. The compensation cost charged against income was \$0.5 million and \$0.6 million, respectively, for the three months ended September 30, 2012 and 2011, respectively, and \$2.1 million and \$1.6 million for the nine months ended September 30, 2012 and 2011, respectively. We currently purchase units in the open market instead of issuing new units for settlement of all unit awards under our Long-Term Incentive Plan. Effective February 2012, the units authorized to be granted under our Long-Term Incentive Plan were increased from 350,000 to 1,250,000 units, of which 916,512 have not yet been granted, assuming no forfeitures of the unvested units and full achievement of goals for the performance units already granted.

Restricted Units

Under our Long-Term Incentive Plan, we grant restricted units to selected employees and non-employee directors who perform services for us, with most awards vesting over a period of one to three years. Although full ownership of the units does not transfer to the recipients until the units vest, the recipients have distribution and voting rights on these units from the date of grant. The fair value of each restricted unit award is measured at the market price as of the date of grant and is amortized over the vesting period.

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 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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A summary of restricted unit activity and changes during the nine months ended September 30, 2012 is presented below:

Restricted Units	Units	Weighted-Average Grant-Date Fair Value	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 2012 (nonvested)	29,536	\$50.45		
Granted	45,264	62.02		
Vesting and transfer of full ownership to recipients	(28,110)	) 52.54		
Forfeited	(1,047)	) 57.32		
Outstanding at September 30, 2012 (nonvested)	45,643	\$60.48	1.1 years	\$2,584

The fair value of restricted units that were vested and transferred to recipients during the nine months ended September 30, 2012 and 2011 were \$1.5 million and \$1.7 million, respectively. As of September 30, 2012, there was \$1.5 million of total unrecognized compensation expense related to nonvested restricted unit grants which is expected to be recognized over a weighted-average period of 1.1 years.

Performance Units

Under our Long-Term Incentive Plan, we grant performance units to selected executives who perform services for us. Performance units granted are payable based upon the growth in our distributable cash flow per common unit over the performance period, and vest over a period of three years. As of September 30, 2012, estimated unit payouts for outstanding nonvested performance unit awards were 110%.

We granted 5,718 performance units to certain officers in March 2012. These units will vest over a three-year performance period ending December 31, 2014 and are payable in HEP common units. The number of units actually earned will be based on the growth of our distributable cash flow per common unit over the performance period, and can range from 50% to 150% of the number of performance units granted. Although common units are not transferred to the recipients until the performance units vest, the recipients have distribution rights with respect to the common units from the date of grant. The fair value of these performance units is based on the grant date closing unit price of \$61.21 and will apply to the number of units ultimately awarded.

A summary of performance unit activity and changes during the nine months ended September 30, 2012 is presented below:

Performance Units	Units
Outstanding at January 1, 2012 (nonvested)	42,991
Granted	5,718
Vesting and transfer of common units to recipients	(21,460)
Outstanding at September 30, 2012 (nonvested)	27,249

For the nine months ended September 30, 2012, we issued 23,391 of our common units having a grant-date fair value of \$0.5 million related to vested performance units having a 109% payout. Based on the weighted average fair value at September 30, 2012 of \$52.11, there was \$0.6 million of total unrecognized compensation expense related to nonvested performance units, which is expected to be recognized over a weighted-average period of 1.0 years.

During the nine months ended September 30, 2012, we paid \$4.9 million for the purchase of our common units in the open market for the issuance and settlement of all unit awards under our Long-Term Incentive Plan.

Note 7: Debt

Credit Agreement

In June 2012, we amended our credit agreement increasing the size of the credit facility from \$375 million to \$550 million. Our \$550 million senior secured revolving credit facility expires in June 2017 (the "Credit Agreement") and is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is

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available also to fund letters of credit up to a \$50 million sub-limit and to fund distributions to unitholders up to a \$60 million sub-limit.

During the nine months ended September 30, 2012, we received advances totaling \$523.0 million and repaid \$292.0 million, resulting in net borrowings of \$231.0 million under the Credit Agreement and an outstanding balance of \$431.0 million at September 30, 2012.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P. (“HEP Logistics”), our general partner, and guaranteed by our material wholly-owned subsidiaries. Any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us, are not significant. We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs.

The Credit Agreement imposes certain requirements on us which we are currently in compliance with, including: a prohibition against distribution to unitholders if, before or after the distribution, a potential default or an event of default as defined in the agreement would occur; limitations on our ability to incur debt, make loans, acquire other companies, change the nature of our business, enter a merger or consolidation, or sell assets; and covenants that require maintenance of a specified EBITDA to interest expense ratio, total debt to EBITDA ratio and senior debt to EBITDA ratio. If an event of default exists under the Credit Agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Senior Notes

In March 2012, we issued \$300 million in aggregate principal amount outstanding of 6.5% senior notes maturing March 1, 2020 (the “6.5% Senior Notes”). Net proceeds of \$294.8 million were used to redeem \$157.8 million aggregate principal amount of our 6.25% senior notes maturing March 1, 2015 (the “6.25% Senior Notes”) tendered pursuant to a cash tender offer and consent solicitation, to repay \$72.9 million in promissory notes due to HFC as discussed below, to pay related fees, expenses and accrued interest in connection with these transactions and to repay borrowings under the Credit Agreement.

In April 2012, we redeemed \$27.2 million aggregate principal amount of 6.25% Senior Notes that remained outstanding following the cash tender offer and consent solicitation.

Also, we have \$150 million in aggregate principal amount outstanding of 8.25% senior notes (the “8.25% Senior Notes”) maturing March 15, 2018.

The 6.5% and 8.25% Senior Notes (collectively, the “Senior Notes”) are unsecured and impose certain restrictive covenants, which we are currently in compliance with, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the Senior Notes are rated investment grade by both Moody’s and Standard & Poor’s and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights under the Senior Notes.

Indebtedness under the Senior Notes is recourse to HEP Logistics, our general partner, and guaranteed by our wholly-owned subsidiaries. However, any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us, are not significant.

Promissory Notes

In November 2011, we issued senior unsecured promissory notes to HFC (the “Promissory Notes”) having an aggregate principal amount of \$150 million to finance a portion of our November 9, 2011 acquisition of assets located at HFC’s El Dorado and Cheyenne refineries (see Note 2). In December 2011, we repaid \$77.1 million of outstanding principal using proceeds received in our December 2011 common unit offering and existing cash. We repaid the remaining \$72.9 million balance in March 2012.

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Long-term Debt

The carrying amounts of our long-term debt are as follows:

	September 30, 2012	December 31, 2011
	(In thousands)	
Credit Agreement	\$431,000	\$200,000
6.5% Senior Notes		
Principal	300,000	—
Unamortized discount	(4,888) —
	295,112	—
6.25% Senior Notes		
Principal	—	185,000
Unamortized net discount	—	(105
	—	) 184,895
8.25% Senior Notes		
Principal	150,000	150,000
Unamortized discount	(1,678	) (1,907
	148,322	) 148,093
Promissory Notes	—	72,900
Total long-term debt	\$874,434	\$605,888

Interest Rate Risk Management

We use interest rate swaps (derivative instruments) to manage our exposure to interest rate risk.

As of September 30, 2012, we have three interest rate swaps that hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on \$305.0 million of Credit Agreement advances. Our first interest rate swap effectively converts \$155.0 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.99% plus an applicable margin of 2.50% as of September 30, 2012, which equaled an effective interest rate of 3.49%. This swap contract matures in February 2016. In August 2012, we entered into two similar interest rate swaps with identical terms which effectively convert \$150.0 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.74% plus an applicable margin of 2.50% as of September 30, 2012, which equaled an effective interest rate of 3.24%. Both of these swap contracts mature in July 2017.

We have designated these interest rate swaps as cash flow hedges. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that these interest rate swaps are effective in offsetting the variability in interest payments on \$305.0 million of our variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedges on a quarterly basis to its fair value with the offsetting fair value adjustment to accumulated other comprehensive loss. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swap against the expected future interest payments on \$305.0 million of our variable rate debt. Any ineffectiveness is recorded directly to interest expense. As of September 30, 2012, we had no ineffectiveness on our cash flow hedges.

At September 30, 2012, we have an accumulated other comprehensive loss of \$5.9 million that relates to our current and previous cash flow hedging instruments. Of this amount, \$2.1 million represents an unrecognized loss attributable to a cash flow hedge terminated in December 2011 and relates to the application of hedge accounting prior to termination. This amount is being amortized as a charge to interest expense through February 2013, the remaining term of the terminated swap contract. Of the remaining \$3.8 million, approximately \$1.0 million will be transferred from accumulated other comprehensive loss into interest expense as interest is paid on the underlying swap agreement over the next twelve-month period, assuming interest rates remain unchanged.

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Additional information on our interest rate swaps is as follows:

Derivative Instrument	Balance Sheet Location (In thousands)	Fair Value	Location of Offsetting Balance	Offsetting Amount
September 30, 2012				
Interest rate swap designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contract (\$305.0 million of LIBOR based debt interest)	Other long-term liabilities	\$3,764	Accumulated other comprehensive loss	\$3,764
December 31, 2011				
Interest rate swap designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contract (\$155.0 million of LIBOR based debt interest)	Other long-term liabilities	\$520	Accumulated other comprehensive loss	\$520

Interest Expense and Other Debt Information

Interest expense consists of the following components:

	Nine Months Ended September 30, 2012 2011 (In thousands)	
Interest on outstanding debt:		
Credit Agreement, net of interest on interest rate swaps	\$5,667	\$7,744
6.5% Senior Notes	10,842	—
6.25% Senior Notes	2,422	8,675
8.25% Senior Notes	9,286	9,286
Promissory Notes	543	—
Amortization of discount and deferred debt issuance costs	5,224	903
Commitment fees	507	332
Total interest incurred	34,491	26,940
Less capitalized interest	222	839
Net interest expense	\$34,269	\$26,101
Cash paid for interest	\$35,007	\$32,006

We recognized a charge of \$3.0 million upon the early extinguishment of debt for the nine months ended September 30, 2012. This charge represents the premium paid to our 6.25% Senior Note holders upon their tender of an aggregate principal amount of \$185.0 million and related net discount.

Note 8: Significant Customers

All revenues are domestic revenues, of which 96% are currently generated from our two largest customers: HFC and Alon. The vast majority of our revenues are derived from activities conducted in the southwest United States.

The following table presents the percentage of total revenues generated by each of these customers:

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	Three Months Ended		Nine Months Ended		
	September 30, 2012	2011	September 30, 2012	2011	
HFC	84	% 83	% 83	% 77	%
Alon	12	% 13	% 12	% 14	%

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Note 9: Related Party Transactions

We serve HFC's refineries under long-term pipeline and terminal, tankage and throughput agreements expiring from 2019 to 2026. Under these agreements, HFC agreed to transport, store and throughput volumes of refined product and crude oil on our pipelines and terminal, tankage and loading rack facilities that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual tariff rate adjustments on July 1, based on the Producer Price Index ("PPI") or Federal Energy Regulatory Commission ("FERC") index. As of September 30, 2012, these agreements with HFC will result in minimum annualized payments to us of \$217.2 million.

If HFC fails to meet its minimum volume commitments under the agreements in any quarter, it will be required to pay us in cash the amount of any shortfall by the last day of the month following the end of the quarter. Under certain of these agreements, a shortfall payment may be applied as a credit in the following four quarters after its minimum obligations are met.

Under certain provisions of an omnibus agreement we have with HFC (the "Omnibus Agreement") we pay HFC an annual administrative fee for the provision by HFC or its affiliates of various general and administrative services to us, currently \$2.3 million. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, which are charged to us separately by HFC. Also, we reimburse HFC and its affiliates for direct expenses they incur on our behalf.

Related party transactions with HFC are as follows:

Revenues received from HFC were \$60.6 million and \$40.7 million for the three months ended September 30, 2012 and 2011, respectively, and \$172.3 million and \$111.9 million for the nine months ended September 30, 2012 and 2011, respectively.

HFC charged us general and administrative services under the Omnibus Agreement of \$0.5 million and \$0.6 million, respectively, for the three months ended September 30, 2012 and 2011, and \$1.7 million for the nine months ended September 30, 2012 and 2011.

We reimbursed HFC for costs of employees supporting our operations of \$7.8 million and \$5.0 million for the three months ended September 30, 2012 and 2011, respectively, and \$22.6 million and \$14.7 million for the nine months ended September 30, 2012 and 2011, respectively.

HFC reimbursed us \$2.9 million and \$1.0 million for the three months ended September 30, 2012 and 2011, respectively, and \$7.5 million and \$9.7 million for the nine months ended September 30, 2012 and 2011, respectively for certain costs paid on their behalf.

We distributed \$16.3 million and \$10.3 million for the three months ended September 30, 2012 and 2011, respectively, to HFC as regular distributions on its common units and general partner interest, including general partner incentive distributions. For the nine months ended September 30, 2012 and 2011, we distributed \$47.3 million and \$30.0 million, respectively.

Accounts receivable from HFC were \$36.3 million and \$31.9 million at September 30, 2012 and December 31, 2011, respectively.

Accounts payable to HFC were \$5.6 million and \$6.5 million at September 30, 2012 and December 31, 2011, respectively.

Revenues for the three and nine months ended September 30, 2012 include \$0.7 million and \$3.2 million of shortfall payments billed in 2011, as HFC did not exceed its minimum volume commitment in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at September 30, 2012 and December 31, 2011, includes

\$7.5 million and \$4.0 million, respectively, relating to certain shortfall billings. It is possible that HFC may not exceed its minimum obligations to receive credit for any of the \$7.5 million deferred at September 30, 2012.

We acquired from HFC 75% interest in the UNEV Pipeline in July 2012 and certain tankage and terminal assets in November 2011. See Note 2 for a description of these transactions.

Note 10: Partners' Equity

As of September 30, 2012, HFC held 12,127,515 of our common units and the 2% general partner interest, which together constituted a 44% ownership interest in us. On July 12, 2012, we issued HFC 1,029,900 of our common units as partial consideration for our

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acquisition of its 75% interest in UNEV, which increased HFC's ownership interest in us from 42% to 44%, inclusive of the general partner interest.

Allocations of Net Income

Net income attributable to HEP is allocated between limited partners and the general partner interest in accordance with the provisions of the partnership agreement. HEP net income allocated to the general partner includes incentive distributions that are declared subsequent to quarter end. After the amount of incentive distributions is allocated to the general partner, the remaining net income attributable to HEP is allocated to the partners based on their weighted-average ownership percentage during the period.

The following table presents the allocation of the general partner interest in net income for the periods presented below:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(In thousands)			
General partner interest in net income	\$392	\$260	\$1,080	\$807
General partner incentive distribution	4,907	3,749	15,644	10,611
Total general partner interest in net income	\$5,299	\$4,009	\$16,724	\$11,418

Cash Distributions

Our general partner, HEP Logistics, is entitled to incentive distributions if the amount we distribute with respect to any quarter exceeds specified target levels.

On October 26, 2012 we announced our cash distribution for the third quarter of 2012 of \$0.925 per unit. The distribution is payable on all common and general partner units and will be paid November 14, 2012 to all unitholders of record on November 5, 2012.

The following table presents the allocation of our regular quarterly cash distributions to the general and limited partners for the periods in which they apply. Our distributions are declared subsequent to quarter end; therefore, the amounts presented do not reflect distributions paid during the periods presented below.

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(In thousands, except per unit data)			
General partner interest	\$659	\$471	\$1,886	\$1,386
General partner incentive distribution	4,907	3,749	15,644	10,611
Total general partner distribution	5,566	4,220	17,530	11,997
Limited partner distribution	26,148	19,318	75,534	57,294
Total regular quarterly cash distribution	\$31,714	\$23,538	\$93,064	\$69,291
Cash distribution per unit applicable to limited partners	\$0.925	\$0.875	\$2.730	\$2.475

As a master limited partnership, we distribute our available cash, which historically has exceeded our net income attributable to Holly Energy Partners because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in our partners' equity since our regular quarterly distributions have exceeded

our quarterly net income attributable to Holly Energy Partners. Additionally, if the assets contributed and acquired from HFC had occurred while we were not a consolidated variable interest entity of HFC, our acquisition cost, in excess of HFC's historical basis in the transferred assets of \$312.8 million, exclusive of depreciation and amortization would have been recorded in our financial statements, as increases to our properties and equipment and intangible assets instead of decreases to our partners' equity.

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Note 11: Supplemental Guarantor/Non-Guarantor Financial Information

Obligations of HEP (“Parent”) under the Senior Notes have been jointly and severally guaranteed by each of its direct and indirect wholly-owned subsidiaries (“Guarantor Subsidiaries”). These guarantees are full and unconditional.

The following financial information presents condensed consolidating balance sheets, statements of comprehensive income, and statements of cash flows of the Parent and the Guarantor Subsidiaries. The information has been presented as if the Parent accounted for its ownership in the Guarantor Subsidiaries using the equity method of accounting.

Prior period amounts have been recast to include UNEV operations acquired July 12, 2012, as if it had been acquired January 1, 2011 and certain tankage, loading rack and crude receiving assets located at HFC’s El Dorado and Cheyenne refineries acquired on November 9, 2011 as if they had been acquired on July 1, 2011, the date upon which HFC obtained control of such assets. This treatment is required as the transactions were between entities under common control.

Condensed Consolidating Balance Sheet

September 30, 2012	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
ASSETS					
Current assets:					
Cash and cash equivalents	\$2	\$ 1,991	\$ —	\$—	\$ 1,993
Accounts receivable	—	34,094	8,738	—	42,832
Intercompany accounts receivable (payable)	63,900	(63,900)	—	—	—
Prepaid and other current assets	344	2,948	1,021	—	4,313
Total current assets	64,246	(24,867)	9,759	—	49,138
Properties and equipment, net	—	543,832	399,772	—	943,604
Investment in subsidiaries	735,086	299,644	—	(1,034,730)	—
Transportation agreements, net	—	96,333	—	—	96,333
Goodwill	—	256,498	—	—	256,498
Investment in SLC Pipeline	—	25,179	—	—	25,179
Other assets	1,738	7,283	—	—	9,021
Total assets	\$801,070	\$ 1,203,902	\$ 409,531	\$(1,034,730)	\$ 1,379,773
LIABILITIES AND PARTNERS’ EQUITY					
Current liabilities:					
Accounts payable	\$—	\$9,847	\$ 1,456	\$—	\$ 11,303
Accrued interest	2,229	277	—	—	2,506
Deferred revenue	—	2,820	6,460	—	9,280
Accrued property taxes	—	3,017	2,023	—	5,040
Other current liabilities	555	1,867	67	—	2,489
Total current liabilities	2,784	17,828	10,006	—	30,618
Long-term debt	443,434	431,000	—	—	874,434

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Other long-term liabilities	—	7,574	—	—	7,574
Class B unit	—	12,414	—	—	12,414
Equity - partners	354,852	735,086	399,525	(1,134,611)	354,852
Equity - noncontrolling interest	—	—	—	99,881	99,881
Total liabilities and partners' equity	\$801,070	\$1,203,902	\$ 409,531	\$(1,034,730)	\$1,379,773

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Condensed Consolidating Balance Sheet

December 31, 2011	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
ASSETS					
Current assets:					
Cash and cash equivalents	\$2	\$3,267	\$ 3,100	\$—	\$6,369
Accounts receivable	—	33,972	4,080	—	38,052
Intercompany accounts receivable (payable)	17,745	(17,745)	—	—	—
Prepaid and other current assets	266	2,378	1,085	—	3,729
Total current assets	18,013	21,872	8,265	—	48,150
Properties and equipment, net	—	553,577	401,287	—	954,864
Investment in subsidiaries	965,377	297,008	—	(1,262,385)	—
Transportation agreements, net	—	101,543	—	—	101,543
Goodwill	—	256,498	—	—	256,498
Investment in SLC Pipeline	—	25,302	—	—	25,302
Other assets	1,322	5,882	—	—	7,204
Total assets	\$984,712	\$ 1,261,682	\$ 409,552	\$(1,262,385)	\$ 1,393,561
LIABILITIES AND PARTNERS' EQUITY					
Current liabilities:					
Accounts payable	\$—	\$ 11,307	\$ 13,542	\$—	\$24,849
Accrued interest	7,498	782	—	—	8,280
Deferred revenue	—	4,032	—	—	4,032
Accrued property taxes	—	2,196	—	—	2,196
Other current liabilities	689	1,088	—	—	1,777
Total current liabilities	8,187	19,405	13,542	—	41,134
Long-term debt	332,988	272,900	—	—	605,888
Other long-term liabilities	—	4,000	—	—	4,000
Equity - partners	643,537	965,377	396,010	(1,361,387)	643,537
Equity - noncontrolling interest	\$—	\$—	\$ —	\$99,002	\$99,002
Total liabilities and partners' equity	\$984,712	\$ 1,261,682	\$ 409,552	\$(1,262,385)	\$ 1,393,561

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

Condensed Consolidating Statement of Comprehensive Income

Three Months Ended September 30, 2012	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$59,025	\$ 1,826	\$(275)	\$60,576
Third parties	—	10,794	1,126	—	11,920
	—	69,819	2,952	(275)	72,496
Operating costs and expenses:					
Operations	—	18,697	2,902	(275)	21,324
Depreciation and amortization	—	9,464	3,580	—	13,044
General and administrative	743	656	—	—	1,399
	743	28,817	6,482	(275)	35,767
Operating income (loss)	(743)	41,002	(3,530)	—	36,729
Equity in earnings (loss) of subsidiaries	34,805	(2,645)	—	(32,160)	—
Equity in earnings of SLC Pipeline	—	877	—	—	877
Interest (expense) income	(8,252)	(4,292)	4	—	(12,540)
	26,553	(6,060)	4	(32,160)	(11,663)
Income (loss) before income taxes	25,810	34,942	(3,526)	(32,160)	25,066
State income tax expense	—	(137)	—	—	(137)
Net income (loss)	25,810	34,805	(3,526)	(32,160)	24,929
Allocation of net loss attributable to Predecessors	146	—	—	—	146
Allocation of net (income) attributable to noncontrolling interests	(1,463)	—	—	881	(582)
Net income (loss) attributable to Holly Energy Partners	24,493	34,805	(3,526)	(31,279)	24,493
Other comprehensive (loss)	(107)	—	—	—	(107)
Comprehensive income (loss)	\$24,386	\$34,805	\$ (3,526)	\$(31,279)	\$24,386

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Condensed Consolidating Statement of Comprehensive Income

Three Months Ended September 30, 2011	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$40,946	\$ —	\$(232)	\$40,714
Third parties	—	8,322	—	—	8,322
	—	49,268	—	(232)	49,036
Operating costs and expenses:					
Operations	—	16,314	316	(232)	16,398
Depreciation and amortization	—	8,737	179	—	8,916
General and administrative	1,166	846	—	—	2,012
	1,166	25,897	495	(232)	27,326
Operating income (loss)	(1,166)	23,371	(495)	—	21,710
Equity in earnings (loss) of subsidiaries	21,039	(371)	—	(20,668)	—
Equity in earnings of SLC Pipeline	—	641	—	—	641
Interest (expense) income	(6,129)	(2,699)	—	—	(8,828)
Other	—	20	—	—	20
	14,910	(2,409)	—	(20,668)	(8,167)
Income (loss) before income taxes	13,744	20,962	(495)	(20,668)	13,543
State income tax expense	—	77	—	—	77
Net income (loss)	13,744	21,039	(495)	(20,668)	13,620
Allocation of net loss attributable to Predecessors	3,000	—	—	—	3,000
Allocation of net loss attributable to noncontrolling interests	—	—	—	124	124
Net income (loss) attributable to Holly Energy Partners	16,744	21,039	(495)	(20,544)	16,744
Other comprehensive income	1,094	—	—	—	1,094
Comprehensive income (loss)	\$17,838	\$21,039	\$ (495)	\$(20,544)	\$17,838

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

Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2012	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$166,062	\$ 7,082	\$(803)	\$172,341
Third parties	—	30,965	3,683	—	34,648
	—	197,027	10,765	(803)	206,989
Operating costs and expenses:					
Operations	—	53,608	8,550	(803)	61,355
Depreciation and amortization	—	29,195	10,704	—	39,899
General and administrative	2,669	3,256	—	—	5,925
	2,669	86,059	19,254	(803)	107,179
Operating income (loss)	(2,669)	110,968	(8,489)	—	99,810
Equity in earnings (loss) of subsidiaries	95,817	(6,364)	—	(89,453)	—
Equity in earnings of SLC Pipeline	—	2,502	—	—	2,502
Interest (expense) income	(23,271)	(11,002)	4	—	(34,269)
Loss on early extinguishment of debt	(2,979)	—	—	—	(2,979)
	69,567	(14,864)	4	(89,453)	(34,746)
Income (loss) before income taxes	66,898	96,104	(8,485)	(89,453)	65,064
State income tax expense	—	(287)	—	—	(287)
Net income (loss)	66,898	95,817	(8,485)	(89,453)	64,777
Allocation of net loss attributable to Predecessors	4,199	—	—	—	4,199
Allocation of net loss attributable to noncontrolling interests	(1,463)	—	—	2,121	658
Net income (loss) attributable to Holly Energy Partners	69,634	95,817	(8,485)	(87,332)	69,634
Other comprehensive income	578	—	—	—	578
Comprehensive income (loss)	\$70,212	\$95,817	\$ (8,485)	\$(87,332)	\$70,212

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

Condensed Consolidating Statement of Comprehensive Income

Nine Months Ended September 30, 2011	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$112,192	\$ —	\$(318)	\$111,874
Third parties	—	33,033	2	—	33,035
	—	145,225	2	(318)	144,909
Operating costs and expenses:					
Operations	—	43,476	646	(318)	43,804
Depreciation and amortization	—	24,090	537	—	24,627
General and administrative	2,869	2,079	—	—	4,948
	2,869	69,645	1,183	(318)	73,379
Operating income (loss)	(2,869)	75,580	(1,181)	—	71,530
Equity in earnings (loss) of subsidiaries	68,652	(886)	—	(67,766)	—
Equity in earnings of SLC Pipeline	—	1,848	—	—	1,848
Interest (expense) income	(18,372)	(7,729)	—	—	(26,101)
Other	—	8	—	—	8
	50,280	(6,759)	—	(67,766)	(24,245)
Income (loss) before income taxes	47,411	68,821	(1,181)	(67,766)	47,285
State income tax expense	—	(169)	—	—	(169)
Net income (loss)	47,411	68,652	(1,181)	(67,766)	47,116
Allocation of net loss attributable to Predecessors	3,515	—	—	—	3,515
Allocation of net loss attributable to noncontrolling interests	—	—	—	295	295
Net income (loss) attributable to Holly Energy Partners	50,926	68,652	(1,181)	(67,471)	50,926
Other comprehensive income	2,648	—	—	—	2,648
Comprehensive income (loss)	\$53,574	\$68,652	\$ (1,181)	\$(67,471)	\$53,574

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

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2012	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Cash flows from operating activities	\$ (14,603)	\$ 122,637	\$ (4,707)	\$—	\$ 103,327
Cash flows from investing activities					
Additions to properties and equipment	—	(18,694)	(13,393)	—	(32,087)
Cash flows from financing activities					
Net borrowings under credit agreement	—	231,000	—	—	231,000
Proceeds from issuance of senior notes	294,750	—	—	—	294,750
Cash distribution to HFC for UNEV acquisition	—	(260,922)	—	—	(260,922)
Repayments of senior notes	(185,000)	—	—	—	(185,000)
Repayment of promissory notes	—	(72,900)	—	—	(72,900)
Capital contribution from partners	1,748	—	15,000	—	16,748
Distributions to HEP unitholders	(91,063)	—	—	—	(91,063)
Purchase of units for incentive grants	(4,919)	—	—	—	(4,919)
Deferred financing costs	(913)	(2,309)	—	—	(3,222)
Other	—	(88)	—	—	(88)
	14,603	(105,219)	15,000	—	(75,616)
Cash and cash equivalents					
Decrease for the period	—	(1,276)	(3,100)	—	(4,376)
Beginning of period	2	3,267	3,100	—	6,369
End of period	\$ 2	\$ 1,991	\$ —	\$—	\$ 1,993

Condensed Consolidating Statement of Cash Flows

Nine Months Ended September 30, 2011	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Cash flows from operating activities	\$ 69,604	\$ (6,958)	\$ 4,743	\$—	\$ 67,389
Cash flows from investing activities					
Additions to properties and equipment	—	(31,493)	(118,392)	—	(149,885)
Cash flows from financing activities					
Net borrowings under credit agreement	—	43,000	—	—	43,000
Distributions to HEP unitholders	(67,963)	—	—	—	(67,963)
Contributions from UNEV's joint venture partners	—	—	123,500	—	123,500
Purchase of units for incentive grants	(1,641)	—	—	—	(1,641)
Deferred financing costs	—	(3,150)	—	—	(3,150)

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Cash and cash equivalents	(69,604) 39,850	123,500	—	93,746
Increase for the period	—	1,399	9,851	—	11,250
Beginning of period	2	401	7,649	—	8,052
End of period	\$2	\$1,800	\$ 17,500	\$—	\$19,302

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HOLLY ENERGY PARTNERS, L.P.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

This Item 2, including but not limited to the sections on "Results of Operations" and "Liquidity and Capital Resources," contains forward-looking statements. See "Forward-Looking Statements" at the beginning of Part I of this Quarterly Report on Form 10-Q. In this document, the words "we," "our," "ours" and "us" refer to Holly Energy Partners, L.P. ("HEP") and its consolidated subsidiaries or to HEP or an individual subsidiary and not to any other person.

OVERVIEW

HEP is a Delaware limited partnership. We own and operate petroleum product and crude oil pipelines and terminal, tankage and loading rack facilities that support the refining and marketing operations of HollyFrontier Corporation ("HFC") in the Mid-Continent, Southwest and Rocky Mountain regions of the United States. At September 30, 2012, HFC owned a 44% interest in us including the 2% general partnership interest. 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 75% interest in UNEV Pipeline, L.L.C, the owner of a HEP operated refined product pipeline running from Utah to Las Vegas, Nevada and related products terminals and a 25% joint venture interest in the SLC Pipeline (the "SLC Pipeline"), a 95-mile intrastate crude oil pipeline system 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 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.

UNEV Pipeline Interest Acquisition

On July 12, 2012, we acquired HFC's 75% interest in UNEV. We paid consideration consisting of \$260.9 million in cash and 1,029,900 of our common units. As a result of the common units issued to HFC, HFC's ownership interest in us increased from 42% to 44% (including the 2% general partner interest). Under the terms of the transaction, we also issued to HFC a Class B unit comprising an equity interest in a wholly-owned subsidiary that entitles HFC to an 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. 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 the next twelve consecutive quarterly periods and up to an additional four quarters in certain circumstances.

Legacy Frontier Pipeline and Tankage Asset Transaction

On November 9, 2011, we acquired from HFC certain tankage, loading rack and crude receiving assets located at HFC's El Dorado and Cheyenne refineries.

See Note 2 "Acquisitions" in the consolidated financial statements for additional information on these acquisitions.

Agreements with HFC and Alon

We serve HFC's refineries under long-term pipeline and terminal, tankage and throughput agreements expiring from 2019 to 2026. Under these agreements, HFC agreed to transport, store and throughput volumes of refined product and crude oil on our pipelines and terminal, tankage and loading rack facilities that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual tariff rate adjustments on July 1, based on the Producer Price Index ("PPI") or Federal Energy Regulatory Commission ("FERC") index. As of September 30, 2012, these agreements with HFC will result in minimum annualized payments to us of \$217.2 million.

If HFC fails to meet its minimum volume commitments under the agreements in any quarter, it will be required to pay us in cash the amount of any shortfall by the last day of the month following the end of the quarter. Under certain of the agreements, a shortfall payment may be applied as a credit in the following four quarters after minimum obligations are met.

We also have a pipelines and terminals agreement with Alon expiring in 2020 under which Alon has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that result in a minimum level of annual revenue that also is subject to annual tariff rate adjustments. The terms under this agreement expire beginning in 2018 through 2022. We also have a capacity lease agreement under which we lease Alon space on our Orla to El Paso pipeline for the shipment of refined product. As of September 30, 2012, these agreements with Alon will result in minimum annualized payments to us of \$31.3 million.

A significant reduction in revenues under these agreements could have a material adverse effect on our results of operations.

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Under certain provisions of the Omnibus Agreement (“Omnibus Agreement”) that we have with HFC, we pay HFC an annual administrative fee, currently \$2.3 million, for the provision by HFC or its affiliates of various general and administrative services to us. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, which are separately charged to us by HFC. We also reimburse HFC and its affiliates for direct expenses they incur on our behalf.

RESULTS OF OPERATIONS (Unaudited)

Income, Distributable Cash Flow and Volumes

The following tables present income, distributable cash flow and volume information for the three and the nine months ended September 30, 2012 and 2011.

	Three Months Ended		Change from
	September 30, 2012	2011		2011
	(In thousands, except per unit data)		
Revenues			
Pipelines:			
Affiliates—refined product pipelines	\$16,350	\$12,414	\$3,936
Affiliates—intermediate pipelines	7,319	5,935	1,384
Affiliates—crude pipelines	12,306	10,846	1,460
	35,975	29,195	6,780
Third parties—refined product pipelines	9,538	6,525	3,013
	45,513	35,720	9,793
Terminals, tanks and loading racks:			
Affiliates	24,601	11,519	13,082
Third parties	2,382	1,797	585
	26,983	13,316	13,667
Total revenues	72,496	49,036	23,460
Operating costs and expenses			
Operations	21,324	16,398	4,926
Depreciation and amortization	13,044	8,916	4,128
General and administrative	1,399	2,012	(613)
	35,767	27,326	8,441
Operating income	36,729	21,710	15,019
Equity in earnings of SLC Pipeline	877	641	236
Interest expense, including amortization	(12,540)	(8,828)	(3,712)
Other	—	20	(20)
	(11,663)	(8,167)	(3,496)
Income before income taxes	25,066	13,543	11,523
State income tax	(137)	77	(214)
Net income	24,929	13,620	11,309
Allocation of net loss attributable to Predecessors ⁽¹⁾	146	3,000	(2,854)
Allocation of net loss (income) attributable to noncontrolling interests	(582)	124	(706)
Net income attributable to Holly Energy Partners	24,493	16,744	7,749
General partner interest in net income, including incentive distributions ⁽²⁾	(5,299)	(4,009)	(1,290)
Limited partners’ interest in net income	\$19,194	\$12,735	\$6,459

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Limited partners' earnings per unit—basic and diluted	\$0.68	\$0.58	\$0.10
Weighted average limited partners' units outstanding	28,268	22,079	6,189
EBITDA ⁽³⁾	\$49,770	\$33,228	\$16,542
Distributable cash flow ⁽⁴⁾	\$40,431	\$25,731	\$14,700
Volumes (bpd)			
Pipelines:			
Affiliates—refined product pipelines	114,113	96,105	18,008
Affiliates—intermediate pipelines	132,220	91,783	40,437
Affiliates—crude pipelines	187,861	175,459	12,402
	434,194	363,347	70,847
Third parties—refined product pipelines	66,274	44,212	22,062
	500,468	407,559	92,909
Terminals and loading racks:			
Affiliates	267,638	183,987	83,651
Third parties	57,496	43,224	14,272
	325,134	227,211	97,923
Total for pipelines and terminal assets (bpd)	825,602	634,770	190,832

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	Nine Months Ended September 30,		Change from
	2012	2011	2011
	(In thousands, except per unit data)		
Revenues			
Pipelines:			
Affiliates—refined product pipelines	\$46,726	\$33,370	\$13,356
Affiliates—intermediate pipelines	21,076	15,637	5,439
Affiliates—crude pipelines	33,844	30,296	3,548
	101,646	79,303	22,343
Third parties—refined product pipelines	27,856	27,588	268
	129,502	106,891	22,611
Terminals, tanks and loading racks:			
Affiliates	70,695	32,571	38,124
Third parties	6,792	5,447	1,345
	77,487	38,018	39,469
Total revenues	206,989	144,909	62,080
Operating costs and expenses			
Operations	61,355	43,804	17,551
Depreciation and amortization	39,899	24,627	15,272
General and administrative	5,925	4,948	977
	107,179	73,379	33,800
Operating income	99,810	71,530	28,280
Equity in earnings of SLC Pipeline	2,502	1,848	654
Interest expense, including amortization	(34,269)	(26,101)	(8,168)
Loss on early extinguishment of debt	(2,979)	—	(2,979)
Other expense	—	8	(8)
	(34,746)	(24,245)	(10,501)
Income before income taxes	65,064	47,285	17,779
State income tax	(287)	(169)	(118)
Net income	64,777	47,116	17,661
Allocation of net loss attributable to Predecessors ⁽¹⁾	4,199	3,515	684
Allocation of net loss attributable to noncontrolling interests	658	295	363
Net income attributable to Holly Energy Partners	69,634	50,926	18,708
General partner interest in net income, including incentive distributions ⁽²⁾	(16,724)	(11,418)	(5,306)
Limited partners' interest in net income	\$52,910	\$39,508	\$13,402
Limited partners' earnings per unit—basic and diluted ⁽²⁾	\$1.91	\$1.79	\$0.12
Weighted average limited partners' units outstanding	27,666	22,079	5,587
EBITDA ⁽³⁾	\$139,165	\$100,282	\$38,883
Distributable cash flow ⁽⁴⁾	\$111,506	\$67,924	\$43,582
Volumes (bpd)			
Pipelines:			
Affiliates—refined product pipelines	104,444	88,172	16,272
Affiliates—intermediate pipelines	130,972	81,618	49,354
Affiliates—crude pipelines	169,922	157,598	12,324
	405,338	327,388	77,950
Third parties—refined product pipelines	62,301	48,107	14,194

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	467,639	375,495	92,144
Terminals and loading racks:			
Affiliates	265,958	174,866	91,092
Third parties	52,918	42,102	10,816
	318,876	216,968	101,908
Total for pipelines and terminal assets (bpd)	786,515	592,463	194,052

We are a consolidated variable interest entity and under common control of HFC. With respect to the July 2012 acquisition of HFC's 75% interest in UNEV, U.S. generally accepted accounting principles ("GAAP") require that (1) our financial statements reflect the historical operations of the assets recognized by HFC, effectively as if the assets were already under

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our ownership and control. Accordingly, we recognized additional revenues of \$0.3 million and \$8.1 million and net losses of \$0.1 million and \$4.2 million for the three and nine months ended September 30, 2012, respectively, that relate to the operations of UNEV prior to our acquisition date. We recognized net losses of \$0.4 million and \$0.9 million for the three and nine months ended September 30, 2011, respectively, that relate to the operations of UNEV. This retrospective adjustment did not have a significant impact on our operating results prior to 2012 as initial start-up activities of the pipeline commenced December 2011. Results of operations of UNEV prior to the acquisition on July 12, 2012 are herein referred to as the Predecessor's results. Additionally, volume information does not reflect volumes prior to our acquisition date.

Net income attributable to Holly Energy Partners is allocated between limited partners and the general partner interest in accordance with the provisions of the partnership agreement. Net income allocated to the general partner includes incentive distributions declared subsequent to quarter end. General partner incentive distributions were (2) \$4.9 million and \$3.7 million for the three months ended September 30, 2012 and 2011, respectively, and \$15.6 million and \$10.6 million for the nine months ended September 30, 2012 and 2011, respectively. Net income attributable to the limited partners is divided by the weighted average limited partner units outstanding in computing the limited partners' per unit interest in net income.

EBITDA is calculated as net income attributable to Holly Energy Partners plus (i) interest expense, net of interest income, (ii) state income tax and (iii) depreciation and amortization (excluding amounts related to Predecessor operations). EBITDA is not a calculation based upon U.S. generally accepted accounting principles ("GAAP"). However, the amounts included in the EBITDA calculation are derived from amounts included in our consolidated financial statements. EBITDA should not be considered as an alternative to net income attributable to Holly (3) Energy Partners or operating income as an indication of our operating performance or as an alternative to operating cash flow as a measure of liquidity. EBITDA is not necessarily comparable to similarly titled measures of other companies. EBITDA is presented here because it is a widely used financial indicator used by investors and analysts to measure performance. EBITDA also is used by our management for internal analysis and as a basis for compliance with financial covenants. Set forth below is our calculation of EBITDA.

	Three Months Ended September 30, 2012		Nine Months Ended September 30, 2011	
	2012	2011	2012	2011
	(In thousands)			
Net income attributable to Holly Energy Partners	\$24,493	\$16,744	\$69,634	\$50,926
Add:				
Interest expense	10,738	8,520	29,045	25,198
Amortization of discount and deferred debt charges	1,802	308	5,224	903
Loss on early extinguishment of debt	—	—	2,979	—
State income tax	137	(77)	287	169
Depreciation and amortization	13,044	8,916	39,899	24,627
Predecessor depreciation and amortization	(444)	(1,183)	(7,903)	(1,541)
EBITDA	\$49,770	\$33,228	\$139,165	\$100,282

(4) Distributable cash flow is not a calculation based upon GAAP. However, the amounts included in the calculation are derived from amounts separately presented in our consolidated financial statements, with the exception of a billed crude revenue settlement and maintenance capital expenditures. Distributable cash flow should not be considered in isolation or as an alternative to net income attributable to Holly Energy Partners or operating income as an indication of our operating performance or as an alternative to operating cash flow as a measure of liquidity. Distributable cash flow is not necessarily comparable to similarly titled measures of other companies. Distributable cash flow is presented here because it is a widely accepted financial indicator used by investors to compare partnership performance. It is also used by management for internal analysis and for our performance units. We

believe that this measure provides investors an enhanced perspective of the operating performance of our assets and the cash our business is generating. Set forth below is our calculation of distributable cash flow.

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	Three Months Ended		Nine Months Ended	
	September 30, 2012	2011	September 30, 2012	2011
Net income attributable to Holly Energy Partners	\$24,493	\$16,744	\$69,634	\$50,926
Add (subtract):				
Depreciation and amortization	13,044	8,916	39,899	24,627
Less predecessor depreciation and amortization	(444)	(1,183)	(7,903)	(1,541)
Amortization of discount and deferred debt charges	1,802	308	5,224	903
Loss on early extinguishment of debt	—	—	2,979	—
Billed crude revenue settlement	917	—	2,753	—
Increase (decrease) in deferred revenue	2,162	1,201	1,733	(3,917)
Maintenance capital expenditures ⁽⁵⁾	(2,287)	(453)	(3,886)	(3,586)
Other non-cash adjustments	744	198	1,073	512
Distributable cash flow	\$40,431	\$25,731	\$111,506	\$67,924

Maintenance capital expenditures are capital expenditures made to replace partially or fully depreciated assets in order to maintain the existing operating capacity of our assets and to extend their useful lives. Maintenance capital expenditures include expenditures required to maintain equipment reliability, tankage and pipeline integrity and safety and to address environmental regulations.

	September 30, 2012	December 31, 2011 (7)
	(In thousands)	
Balance Sheet Data		
Cash and cash equivalents	\$1,993	\$6,369
Working capital	\$18,520	\$7,016
Total assets	\$1,379,773	\$1,393,561
Long-term debt	\$874,434	\$605,888
Partners' equity ⁽⁶⁾	\$354,852	\$643,537

As a master limited partnership, we distribute our available cash, which historically has exceeded our net income attributable to Holly Energy Partners because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in partners' equity since our regular quarterly distributions have exceeded our quarterly net income attributable to Holly Energy Partners. Additionally, if the assets contributed and acquired from HFC while under common control of HFC had been acquired from third parties, our acquisition cost in excess of HFC's basis in the transferred assets of \$312.8 million, exclusive of depreciation and amortization that would have been recorded in our financial statements, as increases to our properties and equipment and intangible assets instead of decreases to partners' equity.

Such amounts have been recast as if UNEV had been under our control at December 31, 2011. The impact on partners' equity from this recast was an increase of \$314 million at December 31, 2011. Accounting rules for transactions between companies under common control require pre-acquisition periods to reflect HFC's historical basis in transferred assets and liabilities, notwithstanding how the transaction is ultimately financed. With the close of the UNEV acquisition in July 2012, we adjusted partners' equity to reflect the actual financing of the transaction. This included cash consideration of approximately \$260.9 million which was financed through long-term borrowings. The reduction in partners' equity when comparing the reported periods is due principally to the recast accounting treatment.

Results of Operations—Three Months Ended September 30, 2012 Compared with Three Months Ended September 30, 2011

Summary

Net income attributable to Holly Energy Partners for the three months ended September 30, 2012 was \$24.5 million, a \$7.7 million increase compared to the three months ended September 30, 2011. This increase in earnings is principally due to increased pipeline

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shipments, earnings attributable to our November 2011 acquisition and annual tariff increases. These factors were offset partially by increased operating costs and expenses and higher interest expense.

Revenues for the three months ended September 30, 2012 include the recognition of \$0.7 million of prior shortfalls billed to shippers in 2011. Deficiency payments of \$4.1 million associated with certain guaranteed shipping contracts were deferred during the three months ended September 30, 2012. Such deferred revenue will be recognized in earnings either as payment for shipments in excess of guaranteed levels, or when shipping rights expire unused.

Revenues

Total revenues for the three months ended September 30, 2012 were \$72.5 million, a \$23.5 million increase compared to the three months ended September 30, 2011. This is principally due to increased pipeline shipments, revenues attributable to our recent acquisitions and the effect of annual tariff increases. Overall pipeline volumes were up 23% compared to the three months ended September 30, 2011.

Revenues from our refined product pipelines were \$25.9 million, an increase of \$6.9 million compared to the three months ended September 30, 2011. This includes \$3.0 million in revenues attributable to the UNEV pipeline which commenced initial start-up activities in December 2011. Volumes shipped on our refined product pipelines averaged 180.4 thousand barrels per day (“mbpd”) compared to 140.3 mbpd for the same period last year.

Revenues from our intermediate pipelines were \$7.3 million, an increase of \$1.4 million compared to the three months ended September 30, 2011. This includes \$1.3 million in revenues attributable to the Tulsa interconnect pipelines which were placed in service in September 2011. Volumes shipped on our intermediate pipelines averaged 132.2 mbpd compared to 91.8 mbpd for the same period last year.

Revenues from our crude pipelines were \$12.3 million, an increase of \$1.5 million compared to the three months ended September 30, 2011. Volumes shipped on our crude pipelines increased to an average of 187.9 mbpd compared to 175.5 mbpd for the same period last year.

Revenues from terminal, tankage and loading rack fees were \$27.0 million, an increase of \$13.7 million compared to the three months ended September 30, 2011. This increase is due principally to \$12.4 million in revenues attributable to our terminal, tankage and loading racks serving HFC's El Dorado and Cheyenne refineries. Refined products terminalled in our facilities increased to an average of 325.1 mbpd compared to 227.2 mbpd for the same period last year.

Operations Expense

Operations expense for the three months ended September 30, 2012 increased by \$4.9 million compared to the three months ended September 30, 2011. This increase is due principally to incremental operating costs of \$1.6 million and \$3.0 million attributable to our recently acquired assets serving HFC's El Dorado and Cheyenne refineries and the UNEV pipeline, respectively, higher throughput levels as well as year-over-year increases in property taxes, maintenance service and payroll costs.

Depreciation and Amortization

Depreciation and amortization for the three months ended September 30, 2012 increased by \$4.1 million compared to the three months ended September 30, 2011. This increase is due principally to depreciation attributable to our recent acquisitions from HFC and capital projects.

General and Administrative

General and administrative costs for the three months ended September 30, 2012 decreased by \$0.6 million compared to the three months ended September 30, 2011 due to timing of professional fees related to recent acquisitions.

Equity in Earnings of SLC Pipeline

Our equity in earnings of the SLC Pipeline was \$0.9 million for the three months ended September 30, 2012 compared to \$0.6 million for the three months ended September 30, 2011.

Interest Expense

Interest expense for the three months ended September 30, 2012 totaled \$12.5 million, an increase of \$3.7 million compared to the three months ended September 30, 2011. This increase reflects interest on a year-over-year increase in debt levels. Our aggregate effective interest rate was 6.7% for the three months ended September 30, 2012 and 2011.

State Income Tax

We recorded state income tax expense of \$137,000 for the three months ended September 30, 2012 which is solely attributable to

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the Texas margin tax. For the three months ended September 30, 2011, we recorded a benefit of \$77,000 which includes a revision to the estimated margin tax.

Results of Operations—Nine Months Ended September 30, 2012 Compared with Nine Months Ended September 30, 2011

Summary

Net income attributable to Holly Energy Partners for the nine months ended September 30, 2012 was \$69.6 million, an \$18.7 million increase compared to the nine months ended September 30, 2011. This increase in earnings is due principally to increased pipeline shipments, earnings attributable to our November 2011 asset acquisition and annual tariff increases. These factors were offset partially by a decrease in previously deferred revenue realized, increased operating costs and expenses, higher interest expense and a loss incurred on the early extinguishment of debt.

Revenues for the nine months ended September 30, 2012 include the recognition of \$3.2 million of prior shortfalls billed to shippers in 2011. Deficiency payments of \$8.7 million associated with certain guaranteed shipping contracts were deferred during the nine months ended September 30, 2012. Such deferred revenue will be recognized in earnings either as payment for shipments in excess of guaranteed levels, or when shipping rights expire unused.

Revenues

Total revenues for the nine months ended September 30, 2012 were \$207.0 million, a \$62.1 million increase compared to the nine months ended September 30, 2011. This is due principally to increased pipeline shipments, revenues attributable to our recent acquisitions and the effect of annual tariff increases, partially offset by a \$6.7 million decrease in previously deferred revenue realized. Overall pipeline volumes were up 25% compared to the nine months ended September 30, 2011.

Revenues from our refined product pipelines were \$74.6 million, an increase of \$13.6 million compared to the nine months ended September 30, 2011. This includes \$10.8 million in revenues attributable to the UNEV pipeline which commenced initial start-up activities in December 2011 and the effects of a \$7.2 million decrease in previously deferred revenue realized. Volumes shipped on our refined product pipelines averaged 166.7 mbpd compared to 136.3 mbpd for the same period last year.

Revenues from our intermediate pipelines were \$21.1 million, an increase of \$5.4 million compared to the nine months ended September 30, 2011. This includes \$3.7 million in revenues attributable to the Tulsa interconnect pipelines, and a \$0.5 million increase in previously deferred revenue realized. Volumes shipped on our intermediate pipelines averaged 131.0 mbpd compared to 81.6 mbpd for the same period last year.

Revenues from our crude pipelines were \$33.8 million, an increase of \$3.5 million compared to the nine months ended September 30, 2011. Volumes shipped on our crude pipelines increased to an average of 169.9 mbpd compared to 157.6 mbpd for the same period last year.

Revenues from terminal, tankage and loading rack fees were \$77.5 million, an increase of \$39.5 million compared to the nine months ended September 30, 2011. This increase is due principally to \$36.0 million in revenues attributable to our terminal, tankage and loading racks serving HFC's El Dorado and Cheyenne refineries. Refined products terminalled in our facilities increased to an average of 318.9 mbpd compared to 217.0 mbpd for the same period last year.

Operations Expense

Operations expense for the nine months ended September 30, 2012 increased by \$17.6 million compared to the nine months ended September 30, 2011. This increase is due principally to incremental operating costs of \$4.3 million and \$7.9 million that are attributable to our recently acquired assets serving HFC's El Dorado and Cheyenne refineries and the UNEV pipeline, respectively, higher throughput levels as well as year-over-year increases in property taxes, maintenance service and payroll costs.

Depreciation and Amortization

Depreciation and amortization for the nine months ended September 30, 2012 increased by \$15.3 million compared to the nine months ended September 30, 2011. This increase is due principally to depreciation attributable to our recent acquisitions from HFC and capital projects.

General and Administrative

General and administrative costs for the nine months ended September 30, 2012 increased by \$1.0 million compared to the nine months ended September 30, 2011 due to timing of professional fees related to recent acquisitions.

Equity in Earnings of SLC Pipeline

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Our equity in earnings of the SLC Pipeline was \$2.5 million for the nine months ended September 30, 2012 compared to \$1.8 million for the nine months ended September 30, 2011.

Interest Expense

Interest expense for the nine months ended September 30, 2012 totaled \$34.3 million, an increase of \$8.2 million compared to the nine months ended September 30, 2011. This increase reflects interest on a year-over-year increase in debt levels. Our aggregate effective interest rate was 6.7% for the nine months ended September 30, 2012 and 2011.

Loss on Early Extinguishment of Debt

We recognized a charge of \$3.0 million upon the early extinguishment of our 6.25% senior notes for the nine months ended September 30, 2012. This charge relates to the premium paid to noteholders upon their tender of an aggregate principal amount of \$185.0 million and related financing costs that were previously deferred.

State Income Tax

We recorded state income taxes of \$287,000 and \$169,000 for the nine months ended September 30, 2012 and 2011, respectively, which are solely attributable to the Texas margin tax.

LIQUIDITY AND CAPITAL RESOURCES

Overview

In June 2012, we amended our credit agreement increasing the size of the credit facility from \$375 million to \$550 million. Our \$550 million senior secured revolving credit facility expires in June 2017 (the "Credit Agreement") and is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is also available to fund letters of credit up to a \$50 million sub-limit and to fund distributions to unitholders up to a \$60 million sub-limit.

During the nine months ended September 30, 2012, we received advances totaling \$523.0 million and repaid \$292.0 million, resulting in net advances of \$231.0 million under the Credit Agreement and an outstanding balance of \$431.0 million at September 30, 2012.

Under our registration statement filed with the SEC using a "shelf" registration process, we currently have the ability to raise up to \$2.0 billion by offering securities, through one or more prospectus supplements that would describe, among other things, the specific amounts, prices and terms of any securities offered and how the proceeds would be used. Any proceeds from the sale of securities would be used for general business purposes, which may include, among other things, funding acquisitions of assets or businesses, working capital, capital expenditures, investments in subsidiaries, the retirement of existing debt and/or the repurchase of common units or other securities.

We believe our current cash balances, future internally generated funds and funds available under the Credit Agreement will provide sufficient resources to meet our working capital liquidity needs for the foreseeable future. Additionally, we funded the \$260.0 million cash portion of our UNEV Pipeline interest acquisition from HFC on July 12, 2012 with advances under the Credit Agreement.

In February, May and August 2012, we paid regular quarterly cash distributions of \$0.885, \$0.895 and \$0.91, respectively, on all units in an aggregate amount of \$91.1 million. Included in these distributions were \$15.6 million of incentive distribution payments to the general partner.

Contemporaneously with our UNEV Pipeline interest acquisition on July 12, 2012, HFC (our general partner) agreed to forego its right to incentive distributions of \$1.25 million per quarter over the next twelve consecutive quarterly periods and up to an additional four quarters in certain circumstances.

Cash and cash equivalents decreased by \$4.4 million during the nine months ended September 30, 2012. The cash flows provided by operating activities of \$103.3 million was less than the cash flows used for financing and investing activities of \$75.6 million and \$32.1 million, respectively. Working capital increased by \$11.5 million to \$18.5 million at September 30, 2012 from \$7.0 million at December 31, 2011.

Cash Flows—Operating Activities

Cash flows from operating activities increased by \$35.9 million from \$67.4 million for the nine months ended September 30, 2011

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to \$103.3 million for the nine months ended September 30, 2012. This increase is due principally to \$52.0 million in additional cash collections from our customers, partially offset by payments attributable to increased operating expenses.

Our major shippers are obligated to make deficiency payments to us if they do not meet their minimum volume shipping obligations. Under certain agreements with these shippers, they have the right to recapture these amounts if future volumes exceed minimum levels. We billed \$3.2 million during the nine months ended September 30, 2011 related to shortfalls that subsequently expired without recapture and were recognized as revenue during the nine months ended September 30, 2012. Another \$4.1 million is included in our accounts receivable at September 30, 2012 related to shortfalls that occurred during the three months ended September 30, 2012.

Cash Flows—Investing Activities

Cash flows used for investing activities decreased by \$117.8 million from \$149.9 million for the nine months ended September 30, 2011 to \$32.1 million for the nine months ended September 30, 2012. During the nine months ended September 30, 2012 and 2011, we invested \$32.1 million and \$149.9 million in additions to properties and equipment, respectively. The decrease is attributable to lower expenditures in 2012 as a result of the completion of the UNEV pipeline in 2011.

Cash Flows—Financing Activities

Cash flows used for financing activities were \$75.6 million for the nine months ended September 30, 2012 compared to cash provided of \$93.7 million for the nine months ended September 30, 2011, a decrease of \$169.4 million. During the nine months ended September 30, 2012, we received \$523.0 million and repaid \$292.0 million in advances under the Credit Agreement, received net proceeds of \$294.8 million from the issuance of our 6.5% senior notes and repaid \$257.9 million of our promissory notes. As partial consideration for the acquisition of HFC's 75% interest in UNEV on July 12, 2012, we paid HFC \$260.9 million in cash (after a customary post-closing working capital adjustment). Additionally, we paid \$91.1 million in regular quarterly cash distributions to our general and limited partners, paid \$3.2 million in financing costs to amend our Credit Agreement and paid \$4.9 million for the purchase of common units for recipients of our incentive grants. We also received contributions of \$16.7 million from UNEV's joint venture partners. During the nine months ended September 30, 2011, we received \$93.0 million and repaid \$50.0 million in advances under the Credit Agreement. Additionally, we paid \$68.0 million in regular quarterly cash distributions to our general and limited partners, we received \$123.5 million from UNEV's joint venture partners, incurred \$3.2 million in financing costs upon the issuance of the 8.25% senior notes, and paid \$1.6 million for the purchase of common units for recipients of our incentive grants.

Capital Requirements

Our pipeline and terminalling operations are capital intensive, requiring investments to maintain, expand, upgrade or enhance existing operations and to meet environmental and operational regulations. Our capital requirements consist of maintenance capital expenditures and expansion capital expenditures. Repair and maintenance expenses associated with existing assets that do not extend their useful life are charged to operating expenses as incurred.

Each year the Holly Logistic Services, L.L.C. ("HLS") board approves our annual capital budget, which specifies capital projects that our management is authorized to undertake. Additionally, at times when conditions warrant or as new opportunities arise, special projects may be approved. The funds allocated for a particular capital project may be expended over a period in excess of a year, depending on the time required to complete the project. Therefore, our planned capital expenditures for a given year consist of expenditures approved for capital projects included in the current year's capital budget as well as, in certain cases, expenditures approved for capital projects in capital budgets for prior years. The 2012 capital budget is comprised of \$8.9 million for maintenance capital expenditures and \$25.8 million for expansion capital expenditures. This HEP capital budget excludes capital costs related to UNEV.

We recently have made certain modifications to our crude oil gathering and trunk line system that effectively have increased our ability to gather and transport an additional 10,000 bpd of Delaware Basin crude oil in response to increased drilling activity in southeast New Mexico. Furthermore, we have developed a project to replace a 5-mile section of this pipeline system that will allow for an additional 15,000 bpd of capacity that will be executed as needed if Delaware Basin crude volumes continue to increase. This project is estimated to cost approximately \$2.0 million. We have a second project that consists of the reactivation and conversion to crude oil service of a 70-mile, 8-inch petroleum products pipeline owned by us. Once in service, this pipeline will initially be capable of transporting up to 35,000 bpd of crude oil from southeast New Mexico to third-party common carrier pipelines in west Texas for further transport to major crude oil markets. The scope of this project is being finalized. Subject to receipt of acceptable shipper support and board approval, this project could be operational in mid 2013.

On July 12, 2012, we acquired HFC's 75% interest in UNEV. We paid consideration consisting of \$260.9 million in cash and 1,029,900 of our common units. As a result of the common units issued to HFC, HFC's ownership interest in us increased from 42% to 44% (including the 2% general partner interest). Under the terms of the transaction, we also issued to HFC a Class B unit

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comprising an equity interest in a wholly-owned subsidiary that entitles HFC to an 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. 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 the next twelve consecutive quarterly periods and up to an additional four quarters in certain circumstances.

We expect that our currently planned sustaining and maintenance capital expenditures, as well as expenditures for acquisitions and capital development projects will be funded with existing cash generated by operations, the sale of additional limited partner common units, the issuance of debt securities and advances under our Credit Agreement, or a combination thereof. With volatility and uncertainty at times in the credit and equity markets, there may be limits on our ability to issue new debt or equity financing. Additionally, due to pricing movements in the debt and equity markets, we may not be able to issue new debt and equity securities at acceptable pricing. Without additional capital beyond amounts available under the Credit Agreement, our ability to obtain funds for some of these capital projects may be limited.

Credit Agreement

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P. (“HEP Logistics”), our general partner, and guaranteed by our material wholly-owned subsidiaries. Any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us, are not significant. We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs.

The Credit Agreement imposes certain requirements on us which we are currently in compliance with, including: a prohibition against distribution to unitholders if, before or after the distribution, a potential default or an event of default as defined in the agreement would occur; limitations on our ability to incur debt, make loans, acquire other companies, change the nature of our business, enter a merger or consolidation, or sell assets; and covenants that require maintenance of a specified EBITDA to interest expense ratio, total debt to EBITDA ratio and senior debt to EBITDA ratio. If an event of default exists under the Credit Agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Senior Notes

In March 2012, we issued \$300 million in aggregate principal amount outstanding of 6.5% senior notes maturing March 1, 2020 (the “6.5% Senior Notes”). Net Proceeds of \$294.8 million were used to redeem \$157.8 million aggregate principal amount of 6.25% senior notes maturing March 1, 2015 (the “6.25 Senior Notes”) tendered pursuant to a cash tender offer and consent solicitation, to repay \$72.9 million in promissory notes due to HFC as discussed below, to pay related fees, expenses and accrued interest in connection with these transactions and to repay borrowings under the Credit Agreement.

In April 2012, we redeemed \$27.2 million aggregate principal amount of 6.25% senior notes that remained outstanding following the cash tender offer and consent solicitation.

Also, we have \$150 million in aggregate principal amount outstanding of 8.25% senior notes maturing March 15, 2018.

Our 6.5% senior notes and 8.25% senior notes (collectively, the “Senior Notes”) are unsecured and impose certain restrictive covenants which we are currently in compliance with, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the Senior Notes are rated investment grade by both Moody’s and Standard & Poor’s and no default or event of default exists, we will not be subject to many of the foregoing

covenants. Additionally, we have certain redemption rights under the Senior Notes.

Indebtedness under the Senior Notes is recourse to HEP Logistics, and guaranteed by our wholly-owned subsidiaries. However, any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us, are not significant.

Promissory Notes

In November 2011, we issued senior unsecured promissory notes to HFC (the “Promissory Notes”) having an aggregate principal amount of \$150.0 million to finance a portion of our November 9, 2011 acquisition of assets located at HFC's El Dorado and Cheyenne refineries. In December 2011, we repaid \$77.1 million of outstanding principal using proceeds received in our December 2011 common unit offering and existing cash. We repaid the remaining \$72.9 million balance in March 2012.

Long-term Debt

The carrying amounts of our long-term debt are as follows:

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	September 30, 2012 (In thousands)	December 31, 2011
Credit Agreement	\$431,000	\$200,000
6.5% Senior Notes		
Principal	300,000	—
Unamortized discount	(4,888) —
	295,112	—
6.25% Senior Notes		
Principal	—	185,000
Unamortized net discount	—	(105
	—	) 184,895
8.25% Senior Notes		
Principal	150,000	150,000
Unamortized discount	(1,678	) (1,907
	148,322	) 148,093
Promissory Notes	—	72,900
Total long-term debt	\$874,434	\$605,888

See “Risk Management” for a discussion of our interest rate swaps.

Contractual Obligations

In June 2012, we amended our credit agreement increasing the size of the credit facility from \$375 million to \$550 million. During the nine months ended September 30, 2012, we repaid net advances of \$231.0 million resulting in \$431.0 million of outstanding borrowings under the Credit Agreement at September 30, 2012.

In March 2012, we issued \$300 million in aggregate principal amount of 6.5% senior notes maturing March 2020.

There were no other significant changes to our long-term contractual obligations during this period.

Impact of Inflation

Inflation in the United States has been relatively moderate in recent years and did not have a material impact on our results of operations for the nine months ended September 30, 2012 and 2011. Historically, the PPI has increased an average of 3.6% annually over the past 5 calendar years.

The substantial majority of our revenues are generated under long-term contracts that provide for increases in our rates and minimum revenue guarantees annually for increases in the PPI. Certain of these contracts have provisions that limit the level of annual PPI percentage rate increases. Although the recent PPI increase may not be indicative of additional increases to be realized in the future, a significant and prolonged period of inflation could adversely affect our cash flows and results of operations if costs increase at a rate greater than the fees we charge our shippers.

Environmental Matters

Our operation of pipelines, terminals, and associated facilities in connection with the transportation and storage of refined products and crude oil is subject to stringent and complex federal, state, and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment. As with the industry generally, compliance with existing and anticipated laws and regulations increases our overall

cost of business, including our capital costs to construct, maintain, and upgrade equipment and facilities. While these laws and regulations affect our maintenance capital expenditures and net income, we believe that they do not affect our competitive position given that the operations of our competitors are similarly affected. We believe that our operations are in substantial compliance with applicable environmental laws and regulations. However, these laws and regulations, and the interpretation or enforcement thereof, are subject to frequent change by regulatory authorities, and we are unable to predict the ongoing cost to us of complying with these laws and regulations or the future impact of these laws and regulations on our operations. Violation of environmental laws, regulations, and permits can result in the imposition of significant administrative, civil and criminal penalties, injunctions, and construction bans or delays. A discharge of hydrocarbons

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or hazardous substances into the environment could, to the extent the event is not insured, subject us to substantial expense, including both the cost to comply with applicable laws and regulations and claims made by employees, neighboring landowners and other third parties for personal injury and property damage.

Under the Omnibus Agreement and certain transportation and purchase agreements with HFC, HFC has agreed to indemnify us, subject to certain limitations, for environmental noncompliance and remediation liabilities associated with certain assets transferred to us from HFC and occurring or existing prior to the date of such transfers.

We have an environmental agreement with Alon with respect to pre-closing environmental costs and liabilities relating to the pipelines and terminals acquired from Alon in 2005, under which Alon will indemnify us through 2015, subject to a \$100,000 deductible and a \$20.0 million maximum liability cap.

There are environmental remediation projects that are currently in progress that relate to certain assets acquired from HFC. Certain of these projects were underway prior to our purchase and represent liabilities of HFC as the obligation for future remediation activities was retained by HFC. At September 30, 2012, we have an accrual of \$1.1 million that relates to environmental clean-up projects for which we have assumed liability. The remaining projects, including assessment and monitoring activities, are covered under the HFC environmental indemnification discussed above and represent liabilities of HFC.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities as of the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions. Our significant accounting policies are described in “Item 7. Management’s Discussion and Analysis of Financial Condition and Operations—Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2011. Certain critical accounting policies that materially affect the amounts recorded in our consolidated financial statements include revenue recognition, assessing the possible impairment of certain long-lived assets and goodwill, and assessing contingent liabilities for probable losses. There have been no changes to these policies in 2012. We consider these policies to be the most critical to understanding the judgments that are involved and the uncertainties that could impact our results of operations, financial condition and cash flows.

RISK MANAGEMENT

We use interest rate swaps (derivative instruments) to manage our exposure to interest rate risk.

As of September 30, 2012, we have three interest rate swaps, designated as a cash flow hedge, that hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on a \$305.0 million of Credit Agreement advances. Our first interest rate swap effectively converts \$155.0 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.99% plus an applicable margin of 2.50% as of September 30, 2012, which equaled an effective interest rate of 3.49%. This swap contract matures in February 2016. In August 2012, we entered into two similar interest rate swaps with identical terms which effectively convert \$150.0 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.74% plus an applicable margin of 2.50% as of September 30, 2012, which equaled an effective interest rate of 3.24%. Both of these swap contracts mature in July 2017.

We review publicly available information on our counterparty in order to review and monitor its financial stability and assess its ongoing ability to honor its commitments under the interest rate swap contract. This counterparty is a large financial institution. Furthermore, we have not experienced, nor do we expect to experience, any difficulty in the counterparty honoring its respective commitment.

The market risk inherent in our debt positions is the potential change arising from increases or decreases in interest rates as discussed below.

At September 30, 2012, we had an outstanding principal balance on our 6.5% and 8.25% Senior Notes of \$300 million and \$150 million, respectively. A change in interest rates would generally affect the fair value of the Senior Notes, but not our earnings or cash flows. At September 30, 2012, the fair values of our 6.5% and 8.25% Senior Notes were \$311.3 million and \$162.4 million, respectively. We estimate a hypothetical 10% change in the yield-to-maturity applicable to the 6.5% and 8.25% Senior Notes at September 30, 2012 would result in a change of approximately \$11.7 million and \$4.6 million, respectively, in the fair value of

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the underlying notes.

For the variable rate Credit Agreement, changes in interest rates would affect cash flows, but not the fair value. At September 30, 2012, borrowings outstanding under the Credit Agreement were \$431.0 million. By means of our cash flow hedges, we have effectively converted the variable rate on \$305.0 million of outstanding borrowings to an average fixed rate of 3.37%.

At September 30, 2012, our cash and cash equivalents included highly liquid investments with a maturity of three months or less at the time of purchase. Due to the short-term nature of our cash and cash equivalents, a hypothetical 10% increase in interest rates would not have a material effect on the fair market value of our portfolio. Since we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially affected by the effect of a sudden change in market interest rates on our investment portfolio.

Our operations are subject to normal hazards of operations, including fire, explosion and weather-related perils. We maintain various insurance coverages, including business interruption insurance, subject to certain deductibles. We are not fully insured against certain risks because such risks are not fully insurable, coverage is unavailable, or premium costs, in our judgment, do not justify such expenditures.

We have a risk management oversight committee that is made up of members from our senior management. This committee monitors our risk environment and provides direction for activities to mitigate, to an acceptable level, identified risks that may adversely affect the achievement of our goals.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices. See “Risk Management” under “Management’s Discussion and Analysis of Financial Condition and Results of Operations” for a discussion of market risk exposures that we have with respect to our cash and cash equivalents and long-term debt, which disclosure should be read in conjunction with the quantitative and qualitative disclosures about market risk contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. We utilize derivative instruments to hedge our interest rate exposure, as discussed under “Risk Management.”

Since we do not own products shipped on our pipelines or terminalled at our terminal facilities, we do not have market risks associated with commodity prices.

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

Our principal executive officer and principal financial officer have evaluated, as required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the “Exchange Act”), our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report on Form 10-Q. Our disclosure controls and procedures are designed to provide reasonable assurance that the information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms. Based upon the evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective as of September 30, 2012 at the reasonable assurance level.

(b) Changes in internal control over financial reporting

There have been no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during our last fiscal quarter that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are a party to various legal and regulatory proceedings, none of which we believe will have a material adverse impact on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes in our risk factors as previously disclosed in Part 1, “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. In addition to the other information set forth in this quarterly report, you should carefully consider the factors discussed in our 2011 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in this quarterly report and in our 2011 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(c) Common Unit Repurchases Made in the Quarter

In the third quarter of 2012, we paid \$0.4 million for the purchase of 5,835 of our common units in the open market for the recipients of our 2012 restricted grants. The following table shows these purchases.

Period	Total Number of Units Purchased	Average Price Paid Per Unit	Total Number of Units Purchased as Part of Publicly Announced Plan or Program	Maximum Number of Units that May Yet be Purchased Under a Publicly Announced Plan or Program
July 2012	—	\$—	—	\$—
August 2012	5,835	\$66.09	—	\$—
September 2012	—	\$—	—	\$—
Total for July to September 2012	5,835		—	

Item 6. Exhibits

The Exhibit Index on page 43 of this Quarterly Report on Form 10-Q lists the exhibits that are filed or furnished, as applicable, as part of the Quarterly Report on Form 10-Q.

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HOLLY ENERGY PARTNERS, L.P.
SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

HOLLY ENERGY PARTNERS, L.P.
(Registrant)

By: HEP LOGISTICS HOLDINGS, L.P.
its General Partner

By: HOLLY LOGISTIC SERVICES, L.L.C.
its General Partner

Date: November 2, 2012

/s/ Douglas S. Aron
Douglas S. Aron
Executive Vice President and
Chief Financial Officer
(Principal Financial Officer)

Date: November 2, 2012

/s/ Scott C. Surplus
Scott C. Surplus
Vice President and Controller
(Principal Accounting Officer)

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Exhibit Index

Exhibit Number	Description
3.1	First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P. (incorporated by reference to Exhibit 3.1 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.2	Amendment No. 1 to the First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P., dated February 28, 2005 (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K Current Report dated February 28, 2005, File No. 1-32225).
3.3	Amendment No. 2 to the First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P., as amended, dated July 6, 2005 (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K Current Report dated July 6, 2005, File No. 1-32225).
3.4	Amendment No. 3 to First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P., dated April 11, 2008 (incorporated by reference to Exhibit 4.1 of Registrant's Current Report on Form 8-K dated April 15, 2008, File No. 1-32225).
3.5	Limited Partial Waiver of Incentive Distribution Rights under the First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P., dated as of July 12, 2012 (incorporated by reference to Exhibit 3.1 of Registrant's Current Report on Form 8-K dated July 12, 2012, File No. 1-32225).
3.6	First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners - Operating Company, L.P. (incorporated by reference to Exhibit 3.2 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.7	First Amended and Restated Agreement of Limited Partnership of HEP Logistics Holdings, L.P. (incorporated by reference to Exhibit 3.4 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.8	First Amended and Restated Limited Liability Company Agreement of Holly Logistic Services, L.L.C. (incorporated by reference to Exhibit 3.5 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.9	Amendment No. 1 to the First Amended and Restated Limited Liability Company Agreement of Holly Logistic Services, L.L.C., dated April 27, 2011 (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K Current Report dated May 3, 2011, File No. 1-32225).
3.10	First Amended and Restated Limited Liability Company Agreement of HEP Logistics GP, L.L.C. (incorporated by reference to Exhibit 3.6 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
4.1+	Fourth Supplemental Indenture, dated August 6, 2012, among HEP UNEV Holdings LLC, HEP UNEV Pipeline LLC, Holly Energy Partners, L.P., Holly Energy Finance Corp., the other guarantors party thereto and U.S. Bank National Association to the Indenture, dated March 10, 2010, among Holly Energy Partners, L.P., Holly Energy Finance Corp., each of the guarantors party thereto and U.S. Bank National Association.
4.2+	First Supplemental Indenture, dated August 6, 2012, among HEP UNEV Holdings LLC, HEP UNEV Pipeline LLC, Holly Energy Partners, L.P., Holly Energy Finance Corp., the other guarantors party thereto and U.S. Bank National Association to the Indenture, dated March 12, 2012, among Holly Energy Partners, L.P., Holly Energy Finance Corp., each of the guarantors party thereto and U.S. Bank National Association.
10.1	LLC Interest Purchase Agreement, dated July 12, 2012, by and among HollyFrontier Corporation, Holly Energy Partners, L.P. and HEP UNEV Holdings LLC (incorporated by reference to Exhibit 10.5 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2012, File No. 1-32225).

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- 10.2 Seventh Amended and Restated Omnibus Agreement, dated July 12, 2012, by and among HollyFrontier Corporation, Holly Energy Partners, L.P. and certain of their respective subsidiaries (incorporated by reference to Exhibit 10.6 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2012, File No. 1-32225).
- 10.3 Amended and Restated Limited Liability Company Agreement of HEP UNEV Holdings LLC, dated July 12, 2012, by and among HEP UNEV Holdings LLC, Holly Energy Partners, L.P. and HollyFrontier Holdings LLC (incorporated by reference to Exhibit 10.7 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2012, File No. 1-32225).
- 10.4 Termination of Option Agreement, dated July 12, 2012, by and among HollyFrontier Corporation, Holly Energy Partners, L.P., Holly Energy Partners - Operating, L.P. and certain of their respective subsidiaries (incorporated by reference to Exhibit 10.8 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2012, File No. 1-32225).
- 31.1+ Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2+ Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1++ Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

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32.2++	Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
	The following financial information from Holly Energy Partners, L.P.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (Extensible Business Reporting Language):
101**	(i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statement of Partners' Equity, and (vi) Notes to Consolidated Financial Statements.
+	Filed herewith.
++	Furnished herewith.
**	Furnished electronically herewith.