

HOLLY ENERGY PARTNERS LP

Form 10-Q

May 05, 2008

Table of Contents

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

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

For the quarterly period ended March 31, 2008

OR

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

For the transition period from _____ to _____.

Commission File Number: 1-32225

HOLLY ENERGY PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

Delaware

20-0833098

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

100 Crescent Court, Suite 1600

Dallas, Texas 75201-6915

(Address of principal executive offices)

(214) 871-3555

(Registrant's telephone number, including area code)

None

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a 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 April 30, 2008 was 8,390,000.

HOLLY ENERGY PARTNERS, L.P.
INDEX

<u>PART I. FINANCIAL INFORMATION</u>	3
<u>FORWARD-LOOKING STATEMENTS</u>	3
<u>Item 1. Financial Statements (Unaudited, except December 31, 2007 Balance Sheet)</u>	4
<u>Consolidated Balance Sheets</u>	4
<u>Consolidated Statements of Income</u>	5
<u>Consolidated Statements of Cash Flows</u>	6
<u>Consolidated Statement of Partners' Equity (Deficit) and Comprehensive Income</u>	7
<u>Notes to Consolidated Financial Statements</u>	8
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	25
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risks</u>	40
<u>Item 4. Controls and Procedures</u>	40
<u>PART II. OTHER INFORMATION</u>	41
<u>Item 1. Legal Proceedings</u>	41
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	41
<u>Item 6. Exhibits</u>	41
<u>SIGNATURES</u>	43
<u>Computation of Ratio of Earnings to Fixed Charges</u>	
<u>Certification of Chief Executive Officer Pursuant to Section 302</u>	
<u>Certification of Chief Financial Officer Pursuant to Section 302</u>	
<u>Certification of Chief Executive Officer Pursuant to Section 906</u>	
<u>Certification of Chief Financial Officer Pursuant to Section 906</u>	

Table of Contents

PART I. FINANCIAL INFORMATION

FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of the federal securities laws. All statements, other than statements of historical fact included in this Form 10-Q, including, but not limited to, those under Results of Operations and Liquidity and Capital Resources in Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations in Part I are forward-looking statements. These statements are based on management's beliefs and assumptions using currently available information and expectations as of the date hereof, are not guarantees of future performance, and involve certain risks and uncertainties. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot assure you that our expectations will prove correct. Therefore, actual outcomes and results could differ materially from what is expressed, implied or forecast in these statements. Any differences could be caused by a number of factors, including, but not limited to:

Risks and uncertainties with respect to the actual quantities of petroleum products and crude oil shipped on our pipelines and/or terminalled in our terminals;

The economic viability of Holly Corporation, Alon USA, Inc. and our other customers;

The demand for refined petroleum products and crude oil in markets we serve;

Our ability to successfully purchase and integrate additional operations in the future;

Our ability to complete previously announced pending or contemplated acquisitions;

The availability and cost of our financing;

The possibility of reductions in production or shutdowns at refineries utilizing our pipeline and terminal facilities;

The effects of current and future government regulations and policies;

Our operational efficiency in carrying out routine operations and capital construction projects;

The possibility of terrorist attacks and the consequences of any such attacks;

General economic conditions; and

Other financial, operations and legal risks and uncertainties detailed from time to time in our Securities and Exchange Commission filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, in conjunction with the forward-looking statements included in this Form 10-Q that are referred to above. When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2007 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.

Table of Contents**Item 1. Financial Statements****Holly Energy Partners, L.P.
Consolidated Balance Sheets**

	March 31, 2008 (Unaudited)	December 31, 2007
	(In thousands, except unit data)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,237	\$ 10,321
Accounts receivable:		
Trade	5,184	6,611
Affiliates	7,773	5,700
	12,957	12,311
Prepaid and other current assets	342	546
Total current assets	21,536	23,178
Properties and equipment, net	274,187	158,600
Transportation agreements, net	125,374	54,273
Other assets	6,209	2,853
Total assets	\$ 427,306	\$ 238,904
LIABILITIES AND PARTNERS EQUITY		
Current liabilities:		
Accounts payable	\$ 4,773	\$ 3,011
Accounts payable affiliates	5,068	6,021
Accrued interest	1,027	2,996
Deferred revenue	5,551	3,700
Accrued property taxes	626	1,177
Other current liabilities	651	827
Short-term borrowings under credit agreement	10,000	
Total current liabilities	27,696	17,732
Commitments and contingencies		
Long-term debt	356,330	181,435
Other long-term liabilities	4,695	1,181
Minority interest	11,145	10,740
Partners equity (deficit):		
Common unitholders (8,390,000 and 8,170,000 units issued and outstanding at March 31, 2008 and December 31, 2007, respectively)	179,034	172,807

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Subordinated unitholders (7,000,000 units issued and outstanding)	(75,779)	(73,725)
Class B subordinated unitholders (937,500 units issued and outstanding)	22,697	22,973
General partner interest (2% interest)	(94,163)	(94,239)
Accumulated other comprehensive loss	(4,349)	
Total partners equity	27,440	27,816
Total liabilities and partners equity	\$ 427,306	\$ 238,904

See accompanying notes.

- 4 -

Table of Contents

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

	Three Months Ended	
	March 31,	
	2008	2007
	(In thousands, except per unit data)	
Revenues:		
Affiliates	\$ 18,318	\$ 13,790
Third parties	8,958	10,082
	27,276	23,872
Operating costs and expenses:		
Operations	9,727	7,733
Depreciation and amortization	4,313	4,071
General and administrative	1,286	1,272
	15,326	13,076
Operating income	11,950	10,796
Other income (expense):		
Interest income	93	185
Interest expense	(3,807)	(3,358)
Gain on sale of assets	36	297
Minority interest in Rio Grande Pipeline Company	(406)	(427)
	(4,084)	(3,303)
Income before income taxes	7,866	7,493
State income tax	(68)	(59)
Net income	7,798	7,434
Less general partner interest in net income	821	580
Limited partners interest in net income	\$ 6,977	\$ 6,854
Net income per limited partner unit - basic and diluted	\$ 0.43	\$ 0.43

Weighted average limited partners units outstanding	16,181	16,108
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See accompanying notes.

- 5 -

Table of Contents

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

	Three Months Ended March	
	31,	
	2008	2007
	(In thousands)	
Cash flows from operating activities		
Net income	\$ 7,798	\$ 7,434
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,313	4,071
Minority interest in Rio Grande Pipeline Company	405	427
Amortization of restricted and performance units	94	302
Gain on sale of assets	(36)	(297)
(Increase) decrease in current assets:		
Accounts receivable	1,427	1,768
Accounts receivable affiliates	(2,073)	1,652
Prepaid and other current assets	204	391
Increase (decrease) in current liabilities:		
Accounts payable	1,762	(1,664)
Accounts payable affiliates	(953)	
Accrued interest	(1,969)	(1,953)
Deferred revenue	1,851	906
Accrued property tax	(551)	(360)
Other current liabilities	(177)	(368)
Other, net	309	284
Net cash provided by operating activities	12,404	12,593
Cash flows from investing activities		
Additions to properties and equipment	(11,086)	(912)
Acquisition of crude pipelines and tankage assets	(171,000)	
Proceeds from sale of assets	36	325
Net cash used for investing activities	(182,050)	(587)
Cash flows from financing activities		
Borrowings under credit agreement	181,000	
Proceeds from issuance of common units	104	
Distributions to partners	(12,623)	(11,538)
Cash contribution from general partner	186	
Purchase of units for restricted grants	(514)	(908)
Deferred financing costs	(591)	
Other		(15)
Net cash provided by (used for) financing activities	167,562	(12,461)

Cash and cash equivalents

Decrease for period	(2,084)	(455)
Beginning of period	10,321	11,555

End of period	\$ 8,237	\$ 11,100
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See accompanying notes.

Table of Contents

Holly Energy Partners, L.P.
Consolidated Statement of Partners Equity (Deficit) and Comprehensive Income
(Unaudited)

	Common Units	Subordinated Units	Class B Subordinated Units	General Partner Interest	Accumulated Other Comprehensive Loss	Total
			(In thousands)			
Balance December 31, 2007	\$ 172,807	\$ (73,725)	\$ 22,973	\$ (94,239)	\$	\$ 27,816
Net income	3,552	3,021	404	821		7,798
Change in fair value of cash flow hedge					(4,349)	(4,349)
Comprehensive income	3,552	3,021	404	821	(4,349)	3,449
Distributions to partners	(5,938)	(5,075)	(680)	(931)		(12,624)
Issuance of common units	9,104					9,104
Cost of issuing common units	(71)					(71)
Capital contribution				186		186
Purchase of units for restricted grants	(514)					(514)
Amortization of restricted and performance units	94					94
Balance March 31, 2008	\$ 179,034	\$ (75,779)	\$ 22,697	\$ (94,163)	\$ (4,349)	\$ 27,440

See accompanying notes.

Table of Contents

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)**

Note 1: Description of Business and Presentation of Financial Statements

Holly Energy Partners, L.P. (HEP) together with its consolidated subsidiaries, is a publicly held master limited partnership, currently 46% owned by Holly Corporation and its subsidiaries (collectively Holly). HEP commenced operations July 13, 2004 upon the completion of its initial public offering. In this document, the words we , our , ours and us refer to HEP unless the context otherwise indicates.

We operate in one business segment the operation of petroleum product and crude gathering pipelines, tankage and terminal facilities.

One of Holly s wholly-owned subsidiaries owns a refinery in Artesia, New Mexico, which Holly operates in conjunction with crude, vacuum distillation and other facilities situated in Lovington, New Mexico (collectively, the Navajo Refinery). The Navajo Refinery produces high-value refined products such as gasoline, diesel fuel and jet fuel and serves markets in the southwestern United States and northern Mexico. We own and operate the two parallel intermediate feedstock pipelines (the Intermediate Pipelines), which connect the New Mexico refining facilities. Our refined product pipelines serve as part of the product distribution network that services the Navajo Refinery. Our terminal operations serving the Navajo Refinery include a truck rack at the Navajo Refinery and four integrated refined product terminals located in New Mexico, Texas and Arizona. On February 29, 2008, we acquired pipeline and tankage assets from Holly (the Crude Pipelines and Tankage Assets) that also service the Navajo Refinery. See Note 2 for a further description of these assets.

Another of Holly s wholly-owned subsidiaries owns a refinery located near Salt Lake City, Utah (the Woods Cross Refinery). Our operations serving the Woods Cross Refinery include a truck rack at the Woods Cross Refinery, a refined product terminal in Spokane, Washington and a 50% non-operating interest in product terminals in Boise and Burley, Idaho. See Note 2 for a description of the Crude Pipelines and Tankage Assets that also service the Woods Cross refinery.

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

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

The consolidated financial statements for the three months ended March 31, 2008 and 2007 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, that, in the opinion of management, are necessary for a fair presentation of our results for the interim periods. Such adjustments are considered to be of a normal recurring nature. Although certain notes and other information required by accounting principles generally accepted in the United States of America have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Form 10-K for the year ended December 31, 2007. 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, 2008.

We have reclassified state income taxes for the three months ended March 31, 2007 to conform to our current presentation at March 31, 2008. State income taxes were previously classified as operations and general and administrative expenses in our consolidated statement of income for the three months ended March 31, 2007.

Table of Contents*Recent Accounting Pronouncements**Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements*

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurements. This standard simplifies and codifies guidance on fair value measurements under generally accepted accounting principles. This standard defines fair value, establishes a framework for measuring fair value and prescribes expanded disclosures about fair value measurements. It also establishes a fair value hierarchy that categorizes inputs used in fair value measurements into three broad levels. Under this hierarchy, quoted prices in active markets for identical assets or liabilities are considered the most reliable evidence of fair value and are given the highest priority level (level 1). Unobservable inputs are considered the least reliable and are given the lowest priority level (level 3). We adopted this standard effective January 1, 2008.

We have interest rate swaps that we measure at fair value on a recurring basis using level 2 inputs. See Note 5 in the Notes to the Consolidated Financial Statements for additional information on these swaps.

SFAS No. 133 Implementation Issue No. E23 Issues Involving the Application of the Shortcut Method under Paragraph 68

In January 2008, the FASB posted SFAS No. 133 Implementation Issue No. E23, Issues Involving the Application of the Shortcut Method under Paragraph 68. This standard addresses issues pertaining to the application of the shortcut method in accounting for hedges when the settlement of a hedged item occurs subsequent to the interest rate swap trade date. It also addresses hedging relationships when the transaction price of an interest rate swap is zero. This standard is effective for hedging relationships designated on or after January 1, 2008 and requires the reassessment of preexisting hedges utilizing the shortcut method under this new guidance. We adopted this standard effective January 1, 2008. The adoption of this standard did not have a material impact on our financial condition, results of operations and cash flows.

Note 2: Acquisition

On February 29, 2008, we acquired the Crude Pipelines and Tankage Assets from Holly for \$180.0 million that consist of crude oil trunk lines that deliver crude oil to Holly's Navajo Refinery in southeast New Mexico, gathering and connection pipelines located in west Texas and New Mexico, on-site crude tankage located within the Navajo and Woods Cross refinery complexes, a jet fuel products pipeline and leased terminal between Artesia and Roswell, New Mexico, and crude oil and product pipelines that support Holly's Woods Cross Refinery. The consideration paid for the Crude Pipelines and Tankage Assets consisted of \$171.0 million in cash and 217,497 of our common units having a fair value of \$9.0 million. We financed the \$171.0 million cash portion of the consideration through borrowings under our senior secured revolving credit agreement expiring August 2011.

In connection with this transaction, we entered into a 15-year crude pipelines and tankage agreement with Holly (the Holly CPTA). Under this agreement, Holly agreed to transport and store volumes of crude oil on the crude pipelines and tankage facilities, respectively that, at the agreed rates, will initially result in minimum annual revenues to us of \$25.3 million. The agreed upon tariffs on the crude pipelines will be adjusted each year at a rate equal to the percentage change in the producer price index (PPI) but will not decrease as a result of a decrease in the PPI. Additionally, Holly amended our omnibus agreement (the Omnibus Agreement) to provide \$7.5 million of indemnification for environmental noncompliance and remediation liabilities associated with the Crude Pipelines and Tankage Assets that occurred or existed prior to our acquisition for a period of up to fifteen years.

The consideration paid for the Crude Pipeline and Tankage Assets was allocated to the individual assets acquired based on management's preliminary fair value estimates. In accounting for this acquisition, we recorded pipeline and terminal assets of \$108.0 and an intangible asset of \$72.0 million, representing the allocated value of the Holly CPTA. This intangible asset is included in Transportation agreements, net in our consolidated balance sheets.

In accordance with the provisions of FASB Interpretation (FIN) No. 46, Holly recognizes us as a variable interest entity (VIE). Under this standard, our purchase of Holly's Crude Pipelines and Tankage Assets qualifies as a reconsideration event whereby Holly reassessed their beneficial interest in us. Following our acquisition of these assets, Holly determined that their beneficial interest in us now exceeds 50%. Accordingly, Holly reconsolidated us effective March 1, 2008.

Table of Contents**Note 3: Properties and Equipment**

	March 31, 2008	December 31, 2007
	(In thousands)	
Pipelines and terminals	\$ 305,088	\$ 196,800
Land and right of way	23,977	22,825
Other	6,394	5,706
Construction in progress	18,061	9,103
	353,520	234,434
Less accumulated depreciation	79,333	75,834
	\$ 274,187	\$ 158,600

During the three months ended March 31, 2008 we capitalized \$0.2 million in interest related to major construction projects. We did not capitalize any interest during the three months ended March 31, 2007.

Note 4: Transportation Agreements

Our transportation recorded agreements consist of the following:

The transportation agreement with Alon USA, Inc (Alon) represents a portion of the total purchase price of assets purchased from Alon in 2005 that was allocated based on an estimated fair value derived under the income approach. This asset is being amortized over 30 years ending 2035, the 15-year initial term of the pipelines and terminals agreement with Alon plus the expected 15-year extension period.

The Holly crude pipelines and tankage agreement represents a portion of the total purchase price of the Crude Pipelines and Tankage Assets that was allocated based on management's preliminary estimate of its fair value. This asset is being amortized over 15 years ending 2023, the 15-year term of the Holly CPTA.

The carrying amounts of our transportation agreements are as follows:

	March 31, 2008	December 31, 2007
	(In thousands)	
Alon transportation agreement	\$ 59,933	\$ 59,933
Holly crude pipelines and tankage agreement	72,000	
	131,933	59,933
Less accumulated amortization	6,559	5,660
	\$ 125,374	\$ 54,273

Note 5: Debt**Credit Agreement**

In February 2008, we amended our \$100 million senior secured revolving credit agreement expiring in August 2011 to increase the size from \$100 million to \$300 million (the Credit Agreement), which we used to finance the \$171.0 million cash portion of the consideration paid for the Crude Pipelines and Tankage Assets acquired from Holly. Union Bank of California, N.A. is one of the lenders and serves as administrative agent under this agreement. As of March 31, 2008 and December 31, 2007, we had \$181.0 million and zero, respectively, outstanding under the

Credit Agreement.

The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. Advances under the Credit Agreement that are either designated for working capital or have been used as interim financing to fund capital expenditures are classified as

- 10 -

Table of Contents

short-term liabilities. Other advances under the Credit Agreement are classified as long-term liabilities. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. During the three months ended March 31, 2008, we received advances totaling \$10.0 million under the Credit Agreement that were used to fund capital expenditures.

We have the right to request an increase in the maximum amount of the Credit Agreement, up to \$370.0 million. Such request will become effective if (a) certain conditions specified in the Credit Agreement are met and (b) existing lenders under the Credit Agreement or other financial institutions reasonably acceptable to the administrative agent commit to lend such increased amounts under the agreement.

Our obligations under the Credit Agreement are secured by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries.

We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs. We are required to reduce all working capital borrowings under the Credit Agreement to zero for a period of at least 15 consecutive days once each twelve-month period prior to the maturity date of the agreement.

Indebtedness under the Credit Agreement bears interest, at our option, at either (a) the reference rate as announced by the administrative agent plus an applicable margin (ranging from 0.25% to 1.50%) or (b) at a rate equal to the London Interbank Offered Rate (LIBOR) plus an applicable margin (ranging from 1.00% to 2.50%). In each case, the applicable margin is based upon the ratio of our funded debt (as defined in the agreement) to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in the Credit Agreement). We incur a commitment fee on the unused portion of the Credit Agreement at a rate ranging from 0.20% to 0.50% based upon the ratio of our funded debt to EBITDA for the four most recently completed fiscal quarters. At March 31, 2008, we are subject to the 0.25% rate on the \$119.0 million of the unused commitment on the Credit Agreement. The agreement matures in August 2011. At that time, the agreement will terminate and all outstanding amounts thereunder will be due and payable.

The Credit Agreement imposes certain requirements, 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 and debt to EBITDA ratio. If an event of default exists under the agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Senior Notes Due 2015

Our senior notes maturing March 1, 2015 are registered with the SEC and bear interest at 6.25% (the Senior Notes). The Senior Notes are unsecured and impose certain restrictive covenants, 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.

Table of Contents

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

	March 31, 2008	December 31, 2007
	(In thousands)	
Credit Agreement	\$ 181,000	\$
Senior Notes		
Principal	185,000	185,000
Unamortized discount	(2,629)	(2,724)
Fair value hedge interest rate swap	2,959	(841)
	185,330	181,435
Total Debt	366,330	181,435
Less short-term borrowing under credit agreement	10,000	
Total long-term debt	\$ 356,330	\$ 181,435

Interest Rate Risk Management

As of March 31, 2008, we have two interest rate swap contracts.

We entered into an interest rate swap to hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on the \$171.0 million Credit Agreement advance that we used to finance our purchase of the Crude Pipelines and Tankage Assets from Holly. This interest rate swap effectively converts our \$171.0 million LIBOR based debt to fixed rate debt having an interest rate of 3.74% plus an applicable margin, currently 1.50%, that results in a March 31, 2008 effective interest rate of 5.24%.

Under the provisions of SFAS No. 133, we have designated this interest rate swap as a cash flow hedge. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that this interest rate swap is effective in offsetting the variability in interest payments on our \$171.0 million variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedge on a quarterly basis to its fair value with a corresponding offset to accumulated other comprehensive income. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest payments on the variable leg of our swap against the expected future interest payments on our \$171.0 million variable rate debt. Any ineffectiveness is reclassified from accumulated other comprehensive income to interest expense. As of March 31, 2008, we had no ineffectiveness on our cash flow hedge.

We also have an interest rate swap contract that effectively converts interest expense associated with \$60.0 million of our 6.25% Senior Notes from a fixed to a variable rate. Under this swap contract, interest on the \$60.0 million notional amount is computed using the three-month LIBOR plus an applicable margin of 1.1575%, which equaled an effective interest rate of 4.23% at March 31, 2008. The maturity of the swap contract is March 1, 2015, matching the maturity of the Senior Notes.

This interest rate swap has been designated as a fair value hedge and meets the requirements to assume no ineffectiveness under the provisions of SFAS No. 133. Accordingly, we use the shortcut method of accounting as prescribed under SFAS No. 133. Under this method, we adjust the carrying value of the swap to its fair value on a quarterly basis, with an offsetting entry to our Senior Notes, effectively adjusting the carrying value of \$60.0 million of principal on the Senior notes to its fair value.

We record interest expense equal to the variable rate payments under the swaps. Receipts under the swap agreements are recorded as a reduction of interest expense.

Table of Contents

Additional information on our interest rate swaps are as follows:

Interest Rate Swaps	Balance Sheet Location	Fair Value (In thousands)	Location of Offsetting Balance
Cash flow hedge - \$171 million LIBOR based debt	Other long-term liabilities	\$4,349	Accumulated other comprehensive loss
Fair value hedge - \$60 million of 6.25% Senior Notes	Other assets	\$2,959	Long-term debt

Other Debt Information

	Three Months Ended March 31, 2008 2007 (In thousands)	
Interest on outstanding debt:		
Senior Notes, net of interest rate swap	\$ 2,710	\$ 2,932
Credit Agreement, net of interest rate swap	803	
Amortization of discount and deferred issuance costs	223	303
Commitment fees	71	123
Net interest expense	\$ 3,807	\$ 3,358
Cash paid for interest ⁽¹⁾	\$ 5,013	\$ 5,135

(1) Net of cash received under our interest rate swap agreement of \$1.9 million for the three months ended March 31, 2008 and 2007.

The estimated fair value of our Senior Notes was \$167.9 million at March 31, 2008.

Note 6: Employees, Retirement and Benefit Plans

Employees who provide direct services to us are employed by Holly Logistic Services, L.L.C., a Holly subsidiary. Their costs, including salaries, bonuses, payroll taxes, benefits, and other direct costs, are charged to us monthly under certain provisions of the Omnibus Agreement that we entered into with Holly in July 2004.

These employees participate in the retirement and benefit plans of Holly. Our share of retirement and benefits costs was \$0.2 million and \$0.4 million for the three months ended March 31, 2008 and 2007, respectively.

We have adopted a 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.

On March 31, 2008, we had two types of equity-based compensation, which are described below. The compensation cost charged against income for these plans was \$0.3 million for the three months ended March 31, 2008 and 2007. It is currently our policy to purchase units in the open market instead of issuing new units for settlement of restricted unit grants. At March 31, 2008, 350,000 units were authorized to be granted under the equity-based compensation plans, of which 243,486 had not yet been granted.

- 13 -

Table of Contents***Restricted Units***

Under our Long-Term Incentive Plan, we grant restricted units to selected employees, consultants and directors who perform services for us, with vesting generally over a period of one to five years. Certain restricted units granted to our directors vest quarterly. 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 vesting for certain key executives is contingent upon certain earnings per unit targets being realized. The fair value of each unit of restricted unit awards was measured at the market price as of the date of grant and is being amortized over the vesting period, including the units issued to the key executives, as we expect those units to fully vest.

A summary of restricted unit activity and changes during the three months ended March 31, 2008, is presented below:

Restricted Units	Grants	Weighted- Average Grant-Date Fair Value	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding January 1, 2008 (not vested)	44,711	\$ 44.77		
Granted	15,902	40.54		
Forfeited	(303)	44.62		
Vesting and transfer of full ownership to recipients	(11,486)	43.53		
Outstanding at March 31, 2008 (not vested)	48,824	\$ 43.69	1.5	\$ 1,874

There were 11,486 restricted units having an intrinsic value of \$0.4 million and a fair value of \$0.5 million that were vested and transferred to recipients during the three months ended March 31, 2008. As of March 31, 2008, there was \$1.1 million of total unrecognized compensation costs related to nonvested restricted unit grants. That cost is expected to be recognized over a weighted-average period of 1.5 years.

Performance Units

Under our Long-Term Incentive Plan, we grant performance units to selected executives and employees who perform services for us. These performance units are payable upon meeting the performance criteria over a service period, and generally vest over a period of three years. The amount payable under the initial performance grant of 1,514 units in 2005 is based upon our unit price and upon our total unitholder return during the requisite period as compared to the total unitholder return of a selected peer group of partnerships. The amount payable under all other performance unit grants is based upon the growth in distributions per limited partner unit during the requisite period.

We granted 14,337 performance units to certain officers in March 2008. These units will vest over a three-year performance period ending December 31, 2010, and are payable in HEP common units. The number of units actually earned will be based on the growth of distributions to limited partners over the performance period, and can range from 50% to 150% of the number of performance units issued. The fair value of these performance units is based on the grant date closing unit price of \$40.54 and will apply to the number of units ultimately awarded.

Table of Contents

A summary of performance units activity and changes during the three months ended March 31, 2008 is presented below:

Performance Units	Payable In Units
Outstanding at January 1, 2008 (not vested)	24,148
Granted	14,337
Forfeited	
Vesting and transfer of full ownership to recipients	(1,514)
Outstanding at March 31, 2008 (not vested)	36,971

There were 1,514 performance units having an intrinsic value of \$0.1 million and a fair value of \$0.1 million that were vested and transferred to recipients during the three months ended March 31, 2008. Based on the weighted average fair value at March 31, 2008 of \$42.10 there was \$1.3 million of total unrecognized compensation cost related to nonvested performance units. That cost is expected to be recognized over a weighted-average period of 1.8 years.

Note 7: Significant Customers

All revenues are domestic revenues, of which over 90% are currently generated from our three largest customers: Holly, Alon and BP Plc (BP). The major concentration of our petroleum products pipeline system's revenue is derived from activities conducted in the southwest United States. The following table presents the percentage of total revenues generated by each of these three customers:

	Three Months Ended March 31,	
	2008	2007
Holly	67%	58%
Alon	19%	26%
BP	10%	13%

Note 8: Related Party Transactions**Holly**

As of March 31, 2008, we serve Holly's refineries in New Mexico and Utah under three 15-year pipeline and terminal agreements.

In connection with our purchase of the Crude Pipelines and Tankage Assets from Holly on February 29, 2008, we entered into the 15-year Holly CPTA. Under the Holly CPTA, Holly agreed to transport and store volumes of crude oil on the crude pipelines and tankage facilities, respectively that, at the agreed rates, will initially result in minimum annual revenues to us of \$25.3 million. The agreed upon tariffs on the crude pipelines will be adjusted each year at a rate equal to the percentage change in the PPI but will not decrease as a result of a decrease in the PPI. Additionally, Holly amended the Omnibus Agreement to provide \$7.5 million of indemnification for environmental noncompliance and remediation liabilities associated with the Crude Pipelines and Tankage Assets that occurred or existed prior to our acquisition for a period of up to fifteen years.

We also have an agreement that relates to the pipelines and terminals contributed by Holly to us at the time of our initial public offering and expires in 2019 (the Holly PTA). Our third agreement with Holly relates to the Intermediate Pipelines acquired from Holly in July 2005 and expires in 2020 (the Holly IPA). The substantial majority of our business is devoted to providing transportation and terminalling services to Holly. The minimum revenue commitments under the Holly PTA and the Holly IPA increase each year at a rate equal to the percentage change in PPI, but will not decrease as a result of a decrease in the PPI.

Table of Contents

Following the July 1, 2007 PPI rate adjustment, the volume commitment by Holly under the Holly PTA will produce at least \$39.6 million of revenue for the twelve months ending June 30, 2008. Under the Holly IPA, Holly agreed to transport volumes of intermediate products on the Intermediate Pipelines that following the July 1, 2007 PPI rate adjustment, will result in minimum funds to us of \$12.8 million for the twelve months ending June 30, 2008.

If Holly fails to meet its minimum volume commitments in any quarter, it is required to pay us in cash the amount of any shortfall by the last day of the month following the end of the quarter. A shortfall payment may be applied as a credit in the following four quarters after Holly's minimum obligations are met.

In October 2007, we entered into an agreement with Holly that amends the Holly PTA under which we have agreed to expand our refined products pipeline system between Artesia, New Mexico and El Paso, Texas (the South System). The expansion of the South System will include replacing 85 miles of 8-inch pipe with 12-inch pipe, adding 150,000 barrels of refined product storage at our El Paso Terminal, improving existing pumps, adding a tie-in to the Kinder Morgan pipeline to Tucson and Phoenix, Arizona, and making related modifications. The cost of this project is estimated to be \$48.3 million. Currently, we are expecting to complete this project by January 2009. The agreement also provides for a tariff increase, expected to be effective May 1, 2008, on Holly shipments on our refined product pipelines.

Under certain provisions of the Omnibus Agreement that we entered with Holly in July 2004 and that expires in 2019, we pay Holly an annual administrative fee for the provision by Holly or its affiliates of various general and administrative services to us. Effective March 1, 2008, the annual fee was increased from \$2.1 million to \$2.3 million to cover additional general and administrative services attributable to the operations of our Crude Pipelines and Tankage Assets. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, such as 401(k), pension and health insurance benefits, which are separately charged to us by Holly. We also reimburse Holly and its affiliates for direct expenses they incur on our behalf.

In consideration for Holly's assistance in obtaining our joint venture opportunity in a new 95-mile intrastate pipeline system (the SLC Pipeline) now under construction by Plains All American Pipeline, L.P. (Plains), we will pay Holly a \$2.5 million finder's fee upon the closing of our investment in the joint venture with Plains. See Note 11 for further information on this proposed joint venture.

Pipeline, terminal and tankage revenues received from Holly were \$18.3 million and \$13.8 million for the three months ended March 31, 2008 and 2007, respectively. These amounts include the revenues received under the Holly PTA, Holly IPA and Holly CPTA.

Holly charged general and administrative services under the Omnibus Agreement of \$0.5 million for the three months ended March 31, 2008 and 2007.

We reimbursed Holly for costs of employees supporting our operations of \$2.6 million and \$2.3 million for the three months ended March 30, 2008 and 2007, respectively.

Holly reimbursed us zero and \$74,000 for the three months ended March 31, 2008 and 2007, respectively, for certain costs paid on their behalf.

We distributed \$6.1 million and \$5.4 million for the three months ended March 31, 2008 and 2007, respectively, to Holly as regular distributions on its subordinated units, common units and general partner interest.

Our accounts receivable from Holly were \$7.8 million and \$5.7 million at March 31, 2008 and December 31, 2007, respectively.

Holly failed to meet its minimum volume commitment for each of the eleven quarters since inception of the Holly IPA. We have charged Holly \$4.8 million for these shortfalls to date, \$0.2 million and zero of which is included in affiliate accounts receivable at March 31, 2008 and December 31, 2007, respectively.

Table of Contents

For the three months ended March 31, 2008, our revenues from Holly included \$0.6 million of shortfalls billed under the Holly IPA in 2007 as Holly did not exceed its minimum volume commitment in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at March 30, 2008 and December 31, 2007, includes \$0.8 million and \$1.1 million, respectively, relating to the Holly IPA. It is possible that Holly may not exceed its minimum obligations under the Holly IPA to allow Holly to receive credit for any of the \$0.8 million deferred at March 31, 2008.

BP

We have a 70% ownership interest in Rio Grande and BP owns the other 30%. Due to the ownership interest and resulting consolidation, BP is a related party to us.

BP's agreement to ship on the Rio Grande pipeline expired on March 31, 2008. Rio Grande is currently serving multiple shippers on the pipeline. We recorded revenues from them of \$2.7 million and \$3.0 million for the three months ended March 31, 2008 and 2007, respectively.

Rio Grande did not pay any distributions for the three months ended March 31, 2008 and 2007.

Included in our accounts receivable trade at March 31, 2008 and December 31, 2007 were \$0.6 million and \$1.5 million, respectively, which represented the receivable balance of Rio Grande from BP.

Alon

We have a 15-year pipelines and terminals agreement with Alon (the Alon PTA), expiring in 2020, under which Alon has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that results in a minimum level of annual revenue. The agreed upon tariffs are increased or decreased annually at a rate equal to the percentage change in PPI, but not below the initial tariff rate. Following the March 1, 2008 PPI rate adjustment, Alon's total minimum commitment for the twelve months ending February 28, 2009 is \$21.9 million.

Alon became a related party when it acquired all of our Class B subordinated units in connection with our acquisition of assets from them on February 28, 2005.

We recognized \$3.4 million and \$4.4 million of revenues for pipeline transportation and terminalling services under the Alon PTA and \$1.8 million under a pipeline capacity lease for the three months ended March 31, 2008 and 2007. The pipeline lease agreement with Alon was amended effective August 31, 2007 to extend two capacity leases for 10 years to August 31, 2018 and July 31, 2020, respectively, to reduce the total leased capacity from 20,000 to 17,500 barrels per day (bpd) effective September 1, 2008, and to allow Alon an option, effective from September 1, 2008, to increase the leased capacity by 2,500 bpd for a term of 10 years.

We paid \$0.7 million and \$0.6 million to Alon for distributions on our Class B subordinated units for the three months ended March 31, 2008 and 2007, respectively.

Included in our accounts receivable trade at March 31, 2008 and December 31, 2007 were \$4.0 million and \$3.5 million, respectively, which represented the receivable balance from Alon.

For the three months ended March 31, 2008, our revenues from Alon included \$0.8 million of shortfalls billed under the Alon PTA in 2007 as Alon did not exceed its minimum revenue obligation in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at March 31, 2008 and December 31, 2007 includes \$4.7 million and \$2.6 million, respectively, relating to the Alon PTA. It is possible that Alon may not exceed its minimum obligations under the Alon PTA to allow Alon to receive credit for any of the \$4.7 million deferred at March 31, 2008.

Table of Contents

Note 9: Partners Equity, Allocations and Cash Distributions

Issuances of units

As partial consideration for our purchase of the Crude Pipelines and Tankage Assets, we issued 217,497 of our common units having a fair value of \$9.0 million to Holly. Additionally, Holly purchased an additional 2,503 of our common units for \$0.1 million and HEP Logistics Holdings, L.P., our general partner, contributed \$0.2 million as an additional capital contribution in order to maintain its 2% general partner interest.

Holly currently holds 7,000,000 of our subordinated units and 290,000 of our common units, which constitutes a 46% ownership interest in us, including the 2% general partner interest.

The Holly-owned subordinated units have the right to receive distributions of available cash from operating surplus in an amount equal to the minimum quarterly distribution of \$0.50 per quarter, plus any arrearages in the payment of the minimum quarterly distribution on the common units from prior quarters, before any distributions of available cash from operating surplus may be made on the subordinated units. The purpose of the subordinated units is to increase the likelihood that cash is available for common unit distributions during the subordination period. The subordination period will extend until the first day of any quarter beginning after June 30, 2009 that each of the following tests are met: distributions of available cash from operating surplus on each of the outstanding common units and subordinated units equaled or exceeded the minimum quarterly distribution for each of the three consecutive, non-overlapping four-quarter periods immediately preceding that date; the adjusted operating surplus (as defined in its partnership agreement) generated during each of the three consecutive, non-overlapping four-quarter periods immediately preceding that date equaled or exceeded the sum of the minimum quarterly distributions on all of the outstanding common units and subordinated units during those periods on a fully diluted basis and the related distribution on the 2% general partner interest during those periods; and there are no arrearages in payment of the minimum quarterly distribution on the common units. If the unitholders remove the general partner without cause, the subordination period may end before June 30, 2009. The Holly-owned subordinated units may convert to common units on a one-for-one basis when certain conditions are met. The partnership agreement sets forth the calculation to be used to determine the amount and priority of cash distributions that the common unitholders, subordinated unitholders and general partner will receive.

Under our registration statement filed with the SEC using a shelf registration process, we may offer from time to time up to \$800.0 million of our 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.

Allocations of Net Income

Net income 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 any incentive distributions declared in the period. After the amount of incentive distributions is allocated to the general partner, the remaining net income for the period is generally allocated to the partners based on their weighted average ownership percentage during the period.

Cash Distributions

We consider regular cash distributions to unitholders on a quarterly basis, although there is no assurance as to the future cash distributions since they are dependent upon future earnings, cash flows, capital requirements, financial condition and other factors. Our Credit Agreement prohibits us from making cash

Table of Contents

distributions if any potential default or event of default, as defined in the Credit Agreement, occurs or would result from the cash distribution.

Within 45 days after the end of each quarter, we will distribute all of our available cash (as defined in our partnership agreement) to unitholders of record on the applicable record date. The amount of available cash generally is all cash on hand at the end of the quarter; less the amount of cash reserves established by our general partner to provide for the proper conduct of our business, comply with applicable law, any of our debt instruments, or other agreements; or provide funds for distributions to our unitholders and to our general partner for any one or more of the next four quarters; plus all cash on hand on the date of determination of available cash for the quarter resulting from working capital borrowings made after the end of the quarter. Working capital borrowings are generally borrowings that are made under our revolving Credit Agreement and in all cases are used solely for working capital purposes or to pay distributions to partners.

We make distributions of available cash from operating surplus for any quarter during any subordination period in the following manner: firstly, 98% to the common unitholders, pro rata, and 2% to the general partner, until we distribute for each outstanding common unit an amount equal to the minimum quarterly distribution for that quarter; secondly, 98% to the common unitholders, pro rata, and 2% to the general partner, until we distribute for each outstanding common unit an amount equal to any arrearages in payment of the minimum quarterly distribution on the common units for any prior quarters during the subordination period; thirdly, 98% to the subordinated unitholders, pro rata, and 2% to the general partner, until we distribute for each subordinated unit an amount equal to the minimum quarterly distribution for that quarter; and thereafter, cash in excess of the minimum quarterly distributions is distributed to the unitholders and the general partner based on the percentages below.

The general partner, HEP Logistics Holdings, L.P., is entitled to incentive distributions if the amount we distribute with respect to any quarter exceeds specified target levels shown below:

	Total Quarterly Distribution	Marginal Percentage Interest in Distributions	
		Unitholders	General Partner
Minimum Quarterly Distribution	Target Amount \$ 0.50	98%	2%
First Target Distribution	Up to \$0.55	98%	2%
Second Target Distribution	above \$0.55 up to \$0.625	85%	15%
Third Target distribution	above \$0.625 up to \$0.75	75%	25%
Thereafter	Above \$0.75	50%	50%

The following table presents the allocation of our regular quarterly cash distributions to the general and limited partners for each period in which declared.

	Three Months Ended March 31,	
	2008	2007
	(In thousands, except per unit data)	
General partner interest	\$ 252	\$ 222
General partner incentive distribution	679	440
Total general partner distribution	931	662

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Limited partner distribution	11,678	10,876
Total regular quarterly cash distribution	\$ 12,609	\$ 11,538
Cash distribution per unit applicable to limited partners	\$ 0.725	\$ 0.675

On April 25, 2008, we announced a cash distribution for the first quarter of 2008 of \$0.735 per unit. The distribution is payable on all common, subordinated, and general partner units and will be paid May 14, 2008 to all unitholders of record on May 5, 2008. The aggregate amount of the distribution will be \$13.0 million, including \$0.7 million paid to the general partner as an incentive distribution.

- 19 -

Table of Contents

As a master limited partnership, we distribute our available cash which has historically exceeded our net income 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 exceed our quarterly net income.

Note 10: Supplemental Guarantor/Non-Guarantor Financial Information

Obligations of Holly Energy Partners, L.P. (Parent) under the 6.25% 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. Rio Grande (Non-Guarantor), in which we have a 70% ownership interest, is the only subsidiary that has not guaranteed these obligations.

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

- 20 -

Table of Contents**Condensed Consolidating Balance Sheet**

March 31, 2008	Parent	Guarantor Subsidiaries	Non- Guarantor (in thousands)	Eliminations	Consolidated
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 2	\$ 3,679	\$ 4,556	\$	\$ 8,237
Accounts receivable		12,337	620		12,957
Intercompany accounts receivable (payable)	(150,588)	150,994	(406)		
Prepaid and other current assets	94	248			342
Total current assets	(150,492)	167,258	4,770		21,536
Properties and equipment, net		241,251	32,936		274,187
Investment in subsidiaries	360,440	26,006		(386,446)	
Transportation agreements, net		125,374			125,374
Other assets	4,212	1,997			6,209
Total assets	\$ 214,160	\$ 561,886	\$ 37,706	\$ (386,446)	\$ 427,306
LIABILITIES AND PARTNERS EQUITY					
Current liabilities:					
Accounts payable	\$	\$ 9,453	\$ 388	\$	\$ 9,841
Accrued interest	(955)	1,982			1,027
Deferred revenue		5,551			5,551
Accrued property taxes		580	46		626
Other current liabilities	2,345	(1,815)	121		651
Short-term borrowings under credit agreement		10,000			10,000
Total current liabilities	1,390	25,751	555		27,696
Long-term debt	185,330	171,000			356,330
Other long-term liabilities		4,695			4,695
Minority interest				11,145	11,145
Partners equity	27,440	360,440	37,151	(397,591)	27,440
Total liabilities and partners equity	\$ 214,160	\$ 561,886	\$ 37,706	\$ (386,446)	\$ 427,306

Condensed Consolidating Balance Sheet

December 31, 2007	Parent	Guarantor Subsidiaries	Non- Guarantor (in thousands)	Eliminations	Consolidated
ASSETS					

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Current assets:										
Cash and cash equivalents	\$	2	\$	8,060	\$	2,259	\$	10,321		
Accounts receivable				10,820		1,491		12,311		
Intercompany accounts receivable (payable)		(141,175)		141,553		(378)				
Prepaid and other current assets		183		363				546		
Total current assets		(140,990)		160,796		3,372		23,178		
Properties and equipment, net				125,383		33,217		158,600		
Investment in subsidiaries		353,235		25,059			(378,294)			
Transportation agreements, net				54,273				54,273		
Other assets		1,302		1,551				2,853		
Total assets	\$	213,547	\$	367,062	\$	36,589	\$	(378,294)	\$	238,904

LIABILITIES AND PARTNERS

EQUITY

Current liabilities:										
Accounts payable	\$		\$	8,499	\$	533	\$	9,032		
Accrued interest		(2,932)		5,928				2,996		
Deferred revenue				3,700				3,700		
Accrued property taxes				1,021		156		1,177		
Other current liabilities		6,387		(5,661)		101		827		
Total current liabilities		3,455		13,487		790		17,732		
Long-term debt		181,435						181,435		
Other long-term liabilities		841		340				1,181		
Minority interest							10,740	10,740		
Partners equity		27,816		353,235		35,799	(389,034)	27,816		
Total liabilities and partners equity	\$	213,547	\$	367,062	\$	36,589	\$	(378,294)	\$	238,904

Table of Contents**Condensed Consolidating Statement of Income**

Three months ended March 31, 2008	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Revenues:					
Affiliates	\$	\$ 18,327	\$	\$	\$ 18,327
Third parties		6,516	2,750	(317)	8,949
		24,843	2,750	(317)	27,276
Operating costs and expenses:					
Operations		8,973	1,071	(317)	9,727
Depreciation and amortization		3,988	325		4,313
General and administrative	742	543	1		1,286
	742	13,504	1,397	(317)	15,326
Operating income (loss)	(742)	11,339	1,353		11,950
Equity in earnings of subsidiaries	11,554	947		(12,501)	
Interest income (expense)	(3,014)	(719)	19		(3,714)
Gain on sale of assets		36			36
Minority interest				(406)	(406)
	8,540	264	19	(12,907)	(4,084)
Income before income taxes	7,798	11,603	1,372	(12,907)	7,866
State income tax		(49)	(19)		(68)
Net income	\$ 7,798	\$ 11,554	\$ 1,353	\$ (12,907)	\$ 7,798

Condensed Consolidating Statement of Income

Three months ended March 31, 2007	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Revenues:					
Affiliates	\$	\$ 13,790	\$	\$	\$ 13,790
Third parties		7,349	3,026	(293)	10,082

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		21,139	3,026	(293)	23,872
Operating costs and expenses:					
Operations		7,233	793	(293)	7,733
Depreciation and amortization		3,223	848		4,071
General and administrative	766	505	1		1,272
	766	10,961	1,642	(293)	13,076
Operating income (loss)	(766)	10,178	1,384		10,796
Equity in earnings of subsidiaries	11,264	997		(12,261)	
Interest income (expense)	(3,064)	(149)	40		(3,173)
Gain on sale of assets		297			297
Minority interest				(427)	(427)
	8,200	1,145	40	(12,688)	(3,303)
Income before income taxes	7,434	11,323	1,424	(12,688)	7,493
State income tax		(59)			(59)
Net income	\$ 7,434	\$ 11,264	\$ 1,424	\$ (12,688)	\$ 7,434

- 22 -

Table of Contents**Condensed Consolidating Statement of Cash Flows**

Three months ended March 31, 2008	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Cash flows from operating activities	\$ 3,908	\$ 6,154	\$ 2,342	\$	\$ 12,404
Cash flows from investing activities					
Additions to properties and equipment		(11,041)	(45)		(11,086)
Acquisition of crude pipelines and tankage assets		(171,000)			(171,000)
Proceeds from sale of assets		36			36
		(182,005)	(45)		(182,050)
Cash flows from financing activities					
Borrowings under credit agreement		181,000			181,000
Proceeds from issuance of common units		104			104
Distributions to partners	(12,437)				(12,437)
Cash distribution to minority interest					
Purchase of units for restricted grants	(514)				(514)
Deferred financing costs		(591)			(591)
	(12,951)	180,513			167,562
Cash and cash equivalents					
Increase (decrease) for the period	(9,043)	4,662	2,297		(2,084)
Beginning of period	2	8,060	2,259		10,321
End of period	\$ (9,041)	\$ 12,722	\$ 4,556	\$	\$ 8,237

Condensed Consolidating Statement of Cash Flows

Three months ended March 31, 2007	Parent	Guarantor Subsidiaries	Non- Guarantor	Eliminations	Consolidated
			(in thousands)		
Cash flows from operating activities	\$ 12,446	\$ (2,934)	\$ 3,081	\$	\$ 12,593
Cash flows from investing activities					
Additions to properties and equipment		(908)	(4)		(912)
Proceeds from sale of assets		325			325
		(583)	(4)		(587)

Cash flows from financing activities				
Distributions to partners	(11,538)			(11,538)
Purchase of units for restricted grants	(908)			(908)
Other		(15)		(15)
	(12,446)	(15)		(12,461)
Cash and cash equivalents				
Increase (decrease) for the period		(3,532)	3,077	(455)
Beginning of period	2	9,819	1,734	11,555
End of period	\$ 2	\$ 6,287	\$ 4,811	\$ 11,100

Table of Contents

Note 11: Proposed Joint Ventures

In November 2007, we executed a definitive agreement with Plains to acquire a 25% joint venture interest in a new 95-mile intrastate pipeline system now under construction by Plains for the shipment of up to 120,000 bpd of crude oil into the Salt Lake City area. Under the agreement, the SLC Pipeline will be owned by a joint venture company that will be owned 75% by Plains and 25% by us. We expect to purchase our 25% interest in the joint venture in the third quarter of 2008 when the SLC Pipeline is expected to become fully operational. The SLC Pipeline will allow various refiners in the Salt Lake City area, including Holly's Woods Cross refinery, to ship crude oil into the Salt Lake City area from the Utah terminus of the Frontier Pipeline as well as crude oil from Wyoming and Utah that is currently flowing on Plains' Rocky Mountain Pipeline. The total cost of our investment in the SLC Pipeline is expected to be \$28 million, including the \$2.5 million finder's fee that is payable to Holly upon the closing of our investment in the SLC Pipeline.

On January 31, 2008, we entered into an option agreement with Holly granting us an option to purchase all of Holly's equity interests in a joint venture pipeline currently under construction. The pipeline will be capable of transporting refined petroleum products from Salt Lake City, Utah to Las Vegas, Nevada (the UNEV Pipeline). Holly currently owns 75% of the equity interests in the UNEV Pipeline. Under this agreement, we have an option to purchase Holly's equity interests in the UNEV Pipeline, effective for a 180-day period commencing when the UNEV Pipeline becomes operational, at a purchase price equal to Holly's investment in the joint venture pipeline plus interest at 7% per annum.

- 24 -

Table of Contents

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.

OVERVIEW

Holly Energy Partners, L.P. (HEP) is a Delaware limited partnership. We own and operate substantially all of the petroleum product pipeline and terminalling assets that support the Holly Corporation (Holly) refining and marketing operations in west Texas, New Mexico, Utah, Idaho and Arizona and a 70% interest in Rio Grande Pipeline Company (Rio Grande). HEP is currently 46% owned by Holly.

We operate a system of petroleum product and crude gathering pipelines in Texas, New Mexico Oklahoma and Utah, distribution terminals in Texas, New Mexico, Arizona, Utah, Idaho, and Washington and refinery tankage in New Mexico and Utah. We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines and by charging fees for terminalling petroleum products and other hydrocarbons, and storing and providing other services at our storage tanks and terminals. We do not take ownership of products that we transport or terminal; therefore, we are not directly exposed to changes in commodity prices.

On February 29, 2008, we acquired pipeline and tankage assets from Holly (the Crude Pipelines and Tankage Assets) for \$180.0 million. The Crude Pipelines and Tankage Assets primarily consist of crude oil trunk lines and gathering lines, product and crude oil pipelines and tankage that service Holly's Navajo and Woods Cross Refineries and a leased jet fuel terminal. Additional information on this transaction is provided under Liquidity and Capital Resources. For the three months ended March 31, 2008, our revenues were \$27.3 million and our net income was \$7.8 million. Our revenues and net income for the three months ended March 31, 2007 were \$23.9 million and \$7.4 million, respectively. Our total operating costs and expenses for the three months ended March 31, 2008 were \$15.3 million, as compared to \$13.1 million for the three months ended March 31, 2007.

Agreements with Holly Corporation

As of March 31, 2008, we serve Holly's refineries in New Mexico and Utah under three 15-year pipeline and terminal agreements.

In connection with our purchase of the Crude Pipelines and Tankage Assets from Holly on February 29, 2008, we entered into a 15-year crude pipelines and tankage agreement with Holly (the Holly CPTA). Under the Holly CPTA, Holly agreed to transport and store volumes of crude oil on the crude pipelines and tankage facilities that, at the agreed rates, will initially result in minimum annual revenues to us of \$25.3 million. The agreed upon tariffs on the crude pipelines will be adjusted each year at a rate equal to the percentage change in the producer price index (PPI) but will not decrease as a result of a decrease in the PPI. Additionally, Holly amended our omnibus agreement (the Omnibus Agreement) to provide \$7.5 million of indemnification for environmental noncompliance and remediation liabilities associated with the Crude Pipelines and Tankage Assets that occurred or existed prior to our acquisition for a period of up to fifteen years.

We also have an agreement that relates to the pipelines and terminals contributed by Holly to us at the time of our initial public offering and expires in 2019 (the Holly PTA). Our third agreement with Holly relates to the Intermediate Pipelines acquired from Holly in July 2005 and expires in 2020 (the Holly IPA). The substantial majority of our business is devoted to providing transportation, storage and terminalling services to Holly. Following the July 1, 2007 rate adjustment for the increased producer price index PPI, the minimum volume commitment by Holly under the Holly PTA will produce at least \$39.6 million of revenue for the twelve months ending June 30, 2008. Under the Holly IPA, Holly agreed to

Table of Contents

transport volumes of intermediate products on the intermediate pipelines that, following the July 1, 2007 PPI adjustment, will result in minimum funds to us of \$12.8 million for the twelve months ended June 30, 2008. If Holly fails to meet its minimum volume commitments 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. A shortfall payment may be applied as a credit in the following four quarters after Holly's minimum obligations are met.

In October 2007, we entered into an agreement with Holly that amends the Holly PTA under which we have agreed to expand our refined products pipeline system between Artesia, New Mexico and El Paso, Texas (the South System). The expansion of the South System will include replacing 85 miles of 8-inch pipe with 12-inch pipe, adding 150,000 barrels of refined product storage at our El Paso Terminal, improving existing pumps, adding a tie-in to the Kinder Morgan pipeline to Tucson and Phoenix, Arizona, and making related modifications. The cost of this project is estimated to be \$48.3 million. Currently, we are expecting to complete this project by January 2009. The agreement also provides for a tariff increase, expected to be effective May 1, 2008, on Holly shipments on our refined product pipelines.

Under certain provisions of the Omnibus Agreement that we entered into with Holly in July 2004 and expires in 2019, we pay Holly an annual administrative fee for the provision by Holly or its affiliates of various general and administrative services to us. Effective March 1, 2008, the annual fee was increased from \$2.1 million to \$2.3 million to cover additional general and administrative services attributable to the operations of our Crude Pipelines and Tankage Assets. This fee does not include the salaries of pipeline and terminal personnel or the cost of their employee benefits, such as 401(k), pension and health insurance benefits, which are separately charged to us by Holly. We also reimburse Holly and its affiliates for direct expenses they incur on our behalf.

- 26 -

Table of Contents**RESULTS OF OPERATIONS (Unaudited)****Income, Distributable Cash Flow and Volumes**

The following tables present income, distributable cash flow and volume information for the three months ended March 31, 2008 and 2007.

	Three Months Ended		Change from 2007
	March 31, 2008	2007	
	(In thousands, except per unit data)		
Revenues			
Pipelines:			
Affiliates refined product pipelines	\$ 9,568	\$ 8,239	\$ 1,329
Affiliates intermediate pipelines	3,593	3,009	584
Affiliates crude pipelines	2,195		2,195
	15,356	11,248	4,108
Third parties refined product pipelines	7,835	8,790	(955)
	23,191	20,038	3,153
Terminals, refinery tankage and truck loading racks:			
Affiliates	2,971	2,542	429
Third parties	1,114	1,292	(178)
	4,085	3,834	251
Total revenues	27,276	23,872	3,404
Operating costs and expenses			
Operations	9,727	7,733	1,994
Depreciation and amortization	4,313	4,071	242
General and administrative	1,286	1,272	14
	15,326	13,076	2,250
Operating income	11,950	10,796	1,154
Interest income	93	185	(92)
Interest expense, including amortization	(3,807)	(3,358)	(449)
Gain on sale of assets	36	297	(261)
Minority interest in Rio Grande	(406)	(427)	21
	(4,084)	(3,303)	(781)
Income before income taxes	7,866	7,493	373

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State income tax	(68)	(59)	(9)
Net income	7,798	7,434	364
Less general partner interest in net income, including incentive distributions ⁽¹⁾	821	580	241
Limited partners interest in net income	\$ 6,977	\$ 6,854	\$ 123
Net income per limited partner unit basic and diluted⁽¹⁾	\$ 0.43	\$ 0.43	\$
Weighted average limited partners units outstanding	16,181	16,108	73
EBITDA ⁽²⁾	\$ 15,893	\$ 14,737	\$ 1,156
Distributable cash flow ⁽³⁾	\$ 13,708	\$ 12,594	\$ 1,114
Volumes barrels per day (bpd)			
Pipelines:			
Affiliates refined product pipelines	84,560	72,361	12,199
Affiliates intermediate pipelines	67,611	59,474	8,137
Affiliates crude pipelines	47,398		47,398
	199,569	131,835	67,734
Third parties refined product pipelines	45,510	65,187	(19,677)
	245,079	197,022	48,057
Terminals and truck loading racks:			
Affiliates	127,436	120,186	7,250
Third parties	37,242	46,846	(9,604)
	164,678	167,032	(2,354)
Total for petroleum pipelines and terminal assets (bpd)	409,757	364,054	45,703

- 27 -

Table of Contents

- (1) Net income 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 any incentive distributions declared in the period. Incentive distributions of \$0.7 million and \$0.4 million were declared during the three months ended March 31, 2008 and 2007, respectively. The net income applicable to the limited partners is divided by the weighted average limited partner units outstanding in computing the net income per unit applicable to limited partners.
- (2) Earnings before interest, taxes, depreciation and amortization (EBITDA) is calculated as net

income plus
(i) interest
expense, net of
interest income
and
(ii) depreciation
and
amortization.
EBITDA is not
a calculation
based upon U.S.
generally
accepted
accounting
principles (U.S.
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 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 is also 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	
	March 31,	
	2008	2007
	(In thousands)	
Net income	\$ 7,798	\$ 7,434
Add interest expense	3,584	3,055
Add amortization of discount and deferred debt issuance costs	223	303
Subtract interest income	(93)	(185)
Add state income tax	68	59
Add depreciation and amortization	4,313	4,071
EBITDA	\$ 15,893	\$ 14,737

- (3) Distributable cash flow is not a calculation based upon U.S. GAAP. However, the amounts included in the calculation are derived from amounts separately presented in our

consolidated financial statements, with the exception of maintenance capital expenditures. Distributable cash flow should not be considered in isolation or as an alternative to net income 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. We believe that this measure provides investors an enhanced perspective of the operating performance of

our assets and
the cash our
business is
generating.

- 28 -

Table of Contents

Set forth below
is our
calculation of
distributable
cash flow.

	Three Months Ended March 31,	
	2008	2007
	(In thousands)	
Net income	\$ 7,798	\$ 7,434
Add depreciation and amortization	4,313	4,071
Add amortization of discount and deferred debt issuance costs	223	303
Add increase in deferred revenue	1,851	906
Subtract maintenance capital expenditures*	(477)	(120)
Distributable cash flow	\$ 13,708	\$ 12,594

* 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.

(4) The amounts reported for the three months ended March 31, 2008 include volumes transported on the crude pipelines for the month of March only. Volumes

shipped during
March 2008
averaged 139.1
thousand barrels
per day (mbpd).
For the three
months ended
March 31, 2008,
crude pipeline
volumes are
based on March
volumes,
averaged over
the 91 days in
the first quarter.
Under the Holly
CPTA, fees are
based on
volumes
transported on
each pipeline
component
comprising the
crude pipeline
system (the
crude oil
gathering
pipelines and
the crude oil
trunk lines).
Accordingly,
volumes
transported on
the crude
pipelines
represent the
sum of volumes
transported on
both pipeline
components. In
cases where
volumes are
transported over
both
components of
the crude
pipeline system,
such volumes
are reflected
twice in the total
crude oil

pipeline
volumes.

	March 31, 2008	December 31, 2007
	(In thousands)	
Balance Sheet Data		
Cash and cash equivalents	\$ 8,237	\$ 10,321
Working capital	\$ (6,160)	\$ 5,446
Total assets	\$427,306	\$238,904
Long-term debt	\$356,330	\$181,435
Partners' equity	\$ 27,440	\$ 27,816

As a master limited partnership, we distribute our available cash which historically has exceeded our net income 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 exceed our quarterly net income.

- 29 -

Table of Contents**Results of Operations Three Months Ended March 31, 2008 Compared with Three Months Ended March 31, 2007*****Summary***

Net income for the three months ended March 31, 2008 increased \$0.4 million as compared to the same period in 2007. The increase in net income for the three months ended March 31, 2008 was principally due to the acquisition of the crude pipelines and tankage assets by HEP from Holly Corporation on February 29, 2008 as well as an increase in volumes shipped by affiliates. The resulting increases in revenue were partially offset by a reduction of revenues from third party shipments resulting from the shutdown of Alon's Big Spring refinery in the first quarter of 2008. Also, contributing to our net income for the three months ended March 31, 2008 was the realization of certain previously deferred revenue. These factors were partially offset by an increase in operating costs and expenses. Revenue of \$3.2 million relating to deficiency payments associated with certain transportation contracts was deferred during the three months ended March 31, 2008. Such revenue will be recognized in future periods either as payment for shipments in excess of minimum required levels or when shipping rights expire unused after a twelve-month period. On February 18, 2008, Alon experienced an explosion and fire at its Big Spring refinery that resulted in the shutdown of production. Lost production attributable to this shutdown resulted in a decrease in third party shipments on our refined product pipelines during the first quarter of 2008. Under our pipelines and terminals agreement with Alon, Alon has committed to a level of product shipments that generally results in a minimum level of revenue. The amount billed to Alon for any shortfalls with respect to these contractual commitments is recorded as deferred revenue and later included in revenue and net income when earned and no longer subject to recapture. Increases in deferred revenue as a result of such shortfalls are included in distributable cash flow when the shortfall occurs. Alon reopened its Big Spring refinery in early April and has resumed production which is currently running at about one-half of refinery capacity. Alon has announced that its goal is to restart additional refinery units beginning in mid-July.

Revenues

Total revenues increased by \$3.4 million to \$27.3 million for the three months ended March 31, 2008 from \$23.9 million for the three months ended March 31, 2007. This increase was principally due to revenues attributable to our newly acquired crude pipelines in addition to an increase in affiliate refined product and intermediate pipeline revenues. Also contributing to the increase in revenues for the three months ended March 31, 2008 was an increase in previously deferred revenue realized. These increases were partially offset by the revenue effect of the decrease in third party shipments.

Revenues from the refined product pipelines increased by \$0.4 million to \$17.4 million for the three months ended March 31, 2008 from \$17.0 million for the three months ended March 31, 2007. This increase was principally due to an increase in affiliate shipments, the effect of the annual tariff increase on refined product shipments and the realization of \$0.8 million of previously deferred revenue. These increases were partially offset by a decrease in third party shipments as a result of the shutdown of Alon's Big Spring refinery. Shipments on our refined product pipelines decreased to an average of 130.1 thousand barrels per day (mbpd) for the three months ended March 31, 2008 as compared to 137.6 mbpd for the three months ended March 31, 2007.

Revenues from the intermediate pipelines increased by \$0.6 million to \$3.6 million for the three months ended March 31, 2008 from \$3.0 million for the three months ended March 31, 2007. This increase was principally due to an increase in volumes shipped on our intermediate pipelines, the effect of the annual tariff increase on intermediate pipeline shipments and a \$0.1 million increase in previously deferred revenue realized. Shipments on our intermediate product pipelines increased to an average of 67.6 mbpd for the three months ended March 31, 2008 as compared to 59.5 mbpd for the three months ended March 31, 2007.

Revenues from the crude pipelines were \$2.2 million for the three months ended March 31, 2008 and shipments on our crude pipelines averaged 139.1 mbpd during March 2008.

Table of Contents

Revenues from terminal, tankage and truck loading rack fees increased by \$0.3 million to \$4.1 million for the three months ended March 31, 2008 from \$3.8 million for the three months ended March 31, 2007. Refined products terminalled in our facilities averaged 164.7 mbpd for the three months ended March 31, 2008 as compared to 167.0 mbpd for the three months ended March 31, 2007.

Operating Costs

Operations expense increased by \$2.0 million from the three months ended March 31, 2007 to the three months ended March 31, 2008. This increase in expense was principally due to increased pipeline maintenance costs, payroll costs and costs related to the operations of our crude pipelines commencing March 1, 2008.

Depreciation and Amortization

Depreciation and amortization increased by \$0.2 million from the three months ended March 31, 2007 to the three months ended March 31, 2008, due principally to depreciation and amortization attributable to our newly acquired crude pipelines, tankage assets and transportation agreement.

General and Administrative

General and administrative costs were \$1.3 million for the three months ended March 31, 2008 and 2007.

Interest Expense

Interest expense for the three months ended March 31, 2008 totaled \$3.8 million, an increase of \$0.4 million from \$3.4 million for the three months ended March 31, 2007. For the three months ended March 31, 2008, interest expense consisted of: \$2.7 million of interest on our senior notes, net of the impact of the interest rate swap; \$0.8 million of interest on outstanding debt under our credit facility, net of the impact of the interest rate swap; \$0.1 million of commitment fees on the unused portion of the credit facility; and \$0.2 million of amortization of the discount on the senior notes and deferred debt issuance costs. For the three months ended March 31, 2007, interest expense consisted of: \$3.0 million of interest on our outstanding debt, net of the impact of the interest rate swap; \$0.1 million of commitment fees on the unused portion of the credit facility; and \$0.3 million of amortization of the discount on the senior notes and deferred debt issuance costs.

Minority Interest in Earnings of Rio Grande

The minority interest related to the 30% of Rio Grande that we do not own reduced our income by \$0.4 million for the three months ended March 31, 2008 and March 31, 2007.

State Income Tax

State income taxes were less than \$0.1 million for the three months ended March 31, 2008 and 2007.

LIQUIDITY AND CAPITAL RESOURCES

Overview

In February 2008, we amended our \$100 million senior secured revolving credit agreement expiring in August 2011 to increase the size from \$100 million to \$300 million (the Credit Agreement), which we used to finance the \$171.0 million cash portion of the consideration paid for the Crude Pipelines and Tankage Assets acquired from Holly. As of March 31, 2008, we had \$181.0 million outstanding under the Credit Agreement.

Table of Contents

The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. Advances under the Credit Agreement that are either designated for working capital or have been used as interim financing to fund capital expenditures are classified as short-term liabilities. Other advances under the Credit Agreement are classified as long-term liabilities. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. During the three months ended March 31, 2008, we received advances totaling \$10.0 million under the Credit Agreement that were used as interim financing for capital expenditures.

Our senior notes maturing March 1, 2015 are registered with the SEC and bear interest at 6.25% (the Senior Notes). The Senior Notes are unsecured and impose certain restrictive covenants, 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.

Under our shelf registration statement, filed September 2, 2005, we may offer from time to time up to \$800.0 million of our 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 our Credit Agreement will provide sufficient resources to meet our working capital liquidity needs for the foreseeable future. In February 2008, we paid a regular cash distribution of \$0.725 on all units, an aggregate amount of \$12.6 million. Included in this distribution was \$0.7 million paid to the general partner as an incentive distribution, as the distribution per unit exceeded \$0.55.

Cash and cash equivalents decreased by \$2.1 million during the three months ended March 31, 2008. The cash flows used for investing activities of \$182.1 million exceeded cash flows provided by operating and financing activities of \$12.4 million and \$167.6 million, respectively. Working capital decreased by \$11.6 million to \$(6.2) million during the three months ended March 31, 2008.

Cash Flows - Operating Activities

Cash flows from operating activities decreased by \$0.2 million from \$12.6 million for the three months ended March 31, 2007 to \$12.4 million for the three months ended March 31, 2008. This decrease is mainly due to a \$0.8 million decrease in cash collections from our major customers, resulting principally from a decrease in third-party revenues, offset by miscellaneous year-over-year changes in collections and payments.

As discussed above, our major shippers are obligated to make deficiency payments to us if we do not receive certain minimum revenue payments. Certain of these shippers then have the right to recapture these amounts if future volumes exceed minimum levels. During the first three months of 2008, we received cash payments of \$0.6 million under these commitments. We billed \$1.4 million for the first three months of 2007 related to shortfalls that occurred during the first quarter of 2007, which expired without recapture and was recognized as revenue in the first quarter of 2008. Another \$3.2 million is included in our accounts receivable at March 31, 2008 related to shortfalls that occurred in the first quarter of 2008.

Cash Flows - Investing Activities

Cash flows used for investing activities increased by \$181.5 million from \$0.6 million for the three months ended March 31, 2007 to \$182.1 million for the three months ended March 31, 2008. Additions to properties and equipment for the three months ended March 31, 2008 were \$11.1 million, an increase of \$10.2 million from \$0.9 million for the three months ended March 31, 2007. Also during the three months

Table of Contents

ended March 31, 2008, we acquired the Crude Pipelines and Tankage Assets from Holly. The cash consideration paid upon closing of this purchase was \$171.0 million. During the three months ended March 31, 2007, we received cash proceeds of \$0.3 million upon the sale of certain assets.

Cash Flows Financing Activities

Cash flows provided by financing activities were \$167.6 million for the three months ended March 31, 2008 as compared to cash flows used for financing activities of \$12.5 million for the three months ended March 31, 2007. During the three months ended March 31, 2008, we borrowed \$181.0 million under our credit agreement of which \$171.0 million was used to finance the cash portion of the consideration paid to acquire the Crude Pipelines and Tankage Assets on February 29, 2008. During the first three months of 2008, we paid cash distributions on all units and the general partner interest in the aggregate amount of \$12.6 million, an increase of \$1.1 million from \$11.5 million in distributions paid during the first three months of 2007. Cash paid for the purchases of units for restricted grants was \$0.7 million for the three months ended March 31, 2008, a decrease of \$0.2 million from \$0.9 million for the three months ended March 31, 2007. Also for the three months ended March 31, 2008, we paid \$0.4 million in deferred financing costs that were attributable to our amended credit agreement.

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 have consisted of, and are expected to continue to consist of, maintenance capital expenditures and expansion capital expenditures. Maintenance capital expenditures represent capital expenditures to replace partially or fully depreciated assets to maintain the operating capacity of existing assets. Maintenance capital expenditures include expenditures required to maintain equipment reliability, tankage and pipeline integrity, safety and to address environmental regulations. Expansion capital expenditures represent capital expenditures to expand the operating capacity of existing or new assets, whether through construction or acquisition. Expansion capital expenditures include expenditures to acquire assets to grow our business and to expand existing facilities, such as projects that increase throughput capacity on our pipelines and in our terminals. Repair and maintenance expenses associated with existing assets that are minor in nature and do not extend the useful life of existing assets are charged to operating expenses as incurred.

Each year the Holly Logistic Services, L.L.C. (HLS) board of directors 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 of years, 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. Our total capital budget for 2008 is \$53.7 million. This consists of budgeted costs for our South System expansion discussed below and other capital expansion and maintenance projects.

In October 2007, we entered into an agreement with Holly that amends the Holly PTA under which we have agreed to expand our South System between Artesia, New Mexico and El Paso, Texas. The expansion of the South System will include replacing 85 miles of 8-inch pipe with 12-inch pipe, adding 150,000 barrels of refined product storage at our El Paso Terminal, improving existing pumps, adding a tie-in to the Kinder Morgan pipeline to Tucson and Phoenix, Arizona, and making related modifications. The cost of this project is estimated to be \$48.3 million. Currently, we are expecting to complete this project in late 2008. The agreement also provides for a tariff increase, expected to be effective May 1, 2008, on Holly shipments on our refined product pipelines.

In November 2007, we executed a definitive agreement with Plains All American Pipeline, L.P. (Plains) to acquire a 25% joint venture interest in a new 95-mile intrastate pipeline system now under construction by Plains for the shipment of up to 120,000 bpd of crude oil into the Salt Lake City area (the SLC Pipeline). Under the agreement, the SLC Pipeline will be owned by a joint venture company that will be owned 75% by Plains and 25% by us. We expect to purchase our 25% interest in the joint venture in the third quarter of 2008 when the SLC Pipeline is expected to become fully operational. The SLC Pipeline

Table of Contents

will allow various refiners in the Salt Lake City area, including Holly's Woods Cross refinery, to ship crude oil into the Salt Lake City area from the Utah terminus of the Frontier Pipeline as well as crude oil from Wyoming and Utah that is currently flowing on Plains' Rocky Mountain Pipeline. The total cost of our investment in the SLC Pipeline is expected to be \$28 million, including a \$2.5 million finder's fee that is payable to Holly upon the closing of our investment in the SLC Pipeline.

On January 31, 2008, we entered into an option agreement with Holly, granting us an option to purchase all of Holly's equity interests in a joint venture pipeline currently under construction. The pipeline will be capable of transporting refined petroleum products from Salt Lake City, Utah to Las Vegas, Nevada (the UNEV Pipeline). Holly currently owns 75% of the equity interests in the UNEV Pipeline. Under this agreement, we have an option to purchase Holly's equity interests in the UNEV Pipeline, effective for a 180-day period commencing when the UNEV Pipeline becomes operational, at a purchase price equal to Holly's investment in the joint venture pipeline, plus interest at 7% per annum. The initial capacity of the pipeline will be 62,000 bpd, with the capacity for further expansion to 120,000 bpd. The total cost of the pipeline project including terminals is expected to be \$300 million. Holly's share of this cost is \$225 million. Construction of this project is currently expected to be completed and operational in late 2009.

We are also studying several other projects that are in various stages of analysis.

We expect that our currently planned expenditures for sustaining and maintenance capital as well as expenditures for acquisitions and capital development projects such as the UNEV Pipeline, SLC Pipeline and South System expansion projects described above will be funded with existing cash balances, cash generated by operations, the sale of additional limited partner units, the issuance of debt securities and advances under our \$300 million senior secured revolving credit agreement maturing August 2011.

Credit Agreement

In February 2008, we amended our \$100 million senior secured revolving credit agreement expiring in August 2011 to increase the size from \$100 million to \$300 million, which we used to finance the \$171.0 million cash portion of the consideration paid for the Crude Pipelines and Tankage Assets acquired from Holly. Union Bank of California, N.A. is one of the lenders and serves as administrative agent under this agreement. As of March 31, 2008 and December 31, 2007, we had \$181.0 million and zero, respectively, outstanding under the Credit Agreement.

The Credit Agreement is available to fund capital expenditures, acquisitions, and working capital and for general partnership purposes. Advances under the Credit Agreement that are either designated for working capital or have been used as interim financing to fund capital expenditures are classified as short-term liabilities. Other advances under the Credit Agreement are classified as long-term liabilities. In addition, the Credit Agreement is available to fund letters of credit up to a \$50.0 million sub-limit and to fund distributions to unitholders up to a \$20.0 million sub-limit. During the three months ended March 31, 2008, we received advances totaling \$10.0 million under the Credit Agreement that were used as interim financing for capital expenditures.

We have the right to request an increase in the maximum amount of the Credit Agreement, up to \$370.0 million. Such request will become effective if (a) certain conditions specified in the Credit Agreement are met and (b) existing lenders under the Credit Agreement or other financial institutions reasonably acceptable to the administrative agent commit to lend such increased amounts under the agreement.

Our obligations under the Credit Agreement are secured by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our wholly-owned subsidiaries.

We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs. We are required to reduce all working capital borrowings under the Credit Agreement to zero for a period of at least 15 consecutive days once each twelve-month period prior to the maturity date of the agreement.

Table of Contents

Indebtedness under the Credit Agreement bears interest, at our option, at either (a) the reference rate as announced by the administrative agent plus an applicable margin (ranging from 0.25% to 1.50%) or (b) at a rate equal to the London Interbank Offered Rate (LIBOR) plus an applicable margin (ranging from 1.00% to 2.50%). In each case, the applicable margin is based upon the ratio of our funded debt (as defined in the agreement) to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in the Credit Agreement). We incur a commitment fee on the unused portion of the Credit Agreement at a rate ranging from 0.20% to 0.50% based upon the ratio of our funded debt to EBITDA for the four most recently completed fiscal quarters. At March 31, 2008, we are subject to the 0.25% rate on the \$119.0 million of the unused commitment on the Credit Agreement. The agreement matures in August 2011. At that time, the agreement will terminate and all outstanding amounts thereunder will be due and payable.

The Credit Agreement imposes certain requirements, 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 and debt to EBITDA ratio. If an event of default exists under the agreement, the lenders will be able to accelerate the maturity of the debt and exercise other rights and remedies.

Senior Notes Due 2015

Our Senior Notes mature on March 1, 2015 and bear interest at 6.25%. The Senior Notes are unsecured and impose certain restrictive covenants, 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.

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

	March 31, 2008	December 31, 2007
	(In thousands)	
Credit Agreement	\$ 181,000	\$
Senior Notes		
Principal	185,000	185,000
Unamortized discount	(2,629)	(2,724)
Fair value hedge interest rate swap	2,959	(841)
	185,330	181,435
Total Debt	366,330	181,435
Less short-term borrowing under credit agreement	10,000	
Total long-term debt	\$ 356,330	\$ 181,435

See Risk Management for a discussion of our interest rate swap.

Holly Crude Pipelines and Tankage Transaction

On February 29, 2008, we acquired pipeline and tankage assets from Holly for \$180.0 million. The Crude Pipelines and Tankage Assets consist of crude oil trunk lines that deliver crude to Holly's Navajo Refinery in southeast New Mexico, gathering and connection pipelines located in west Texas and New Mexico, on-site crude tankage located within the Navajo and Woods Cross refinery complexes, a jet fuel products pipeline and leased terminal between

Artesia and Roswell, New Mexico, and crude oil and product pipelines that support Holly's Woods Cross Refinery. The consideration paid for the Crude Pipelines and Tankage Assets consisted of \$171.0 million in cash and 217,497 of our common units having a fair value of \$9.0 million. We financed the \$171.0 million cash

- 35 -

Table of Contents

portion of the consideration through borrowings under our Credit Agreement expiring August 2011. In connection with our purchase of the Crude Pipelines and Tankage Assets from Holly on February 29, 2008, we entered into the 15-year Holly CPTA. Under the Holly CPTA, Holly agreed to transport and store volumes of crude oil on the crude pipelines and tankage facilities, respectively that, at the agreed rates, will initially result in minimum annual revenues to us of \$25.3 million. The agreed upon tariffs on the crude pipelines will be adjusted each year at a rate equal to the percentage change in the PPI but will not decrease as a result of a decrease in the PPI. Additionally, Holly amended the Omnibus Agreement to provide \$7.5 million of indemnification for environmental noncompliance and remediation liabilities associated with the Crude Pipelines and Tankage Assets that occurred or existed prior to our acquisition for a period of up to fifteen years.

The consideration paid for the Crude Pipeline and Tankage Assets was allocated to the individual assets acquired based on their estimated fair values. In accounting for this acquisition, we recorded pipeline and terminal assets of \$108.0 million and an intangible asset of \$72.0 million, representing the allocated value of the 15-year Holly CPTA. This intangible asset is included in Transportation agreements, net in our consolidated balance sheets.

Impact of Inflation

Inflation in the United States has been relatively low in recent years and did not have a material impact on our results of operations for the three months ended March 31, 2008 and 2007.

A substantial majority of our revenues are generated under long-term contracts that include the right to increase our rates and minimum revenue guarantees annually for increases in the PPI. Historically, the PPI has increased an average of 3.7% annually over the past 3 calendar years.

Environmental Matters

Our operation of pipelines, terminals, and associated facilities in connection with the storage and transportation 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 in 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 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. We inspect our pipelines regularly using equipment rented from third-party suppliers. Third parties also assist us in interpreting the results of the inspections.

In connection with our acquisition of the Crude Pipelines and Tankage Assets on February 29, 2008, Holly amended the Omnibus Agreement to provide \$7.5 million of indemnification for environmental noncompliance and remediation liabilities associated with the newly acquired assets for a period of up to fifteen years. The Omnibus Agreement also provides up to \$15.0 million in environmental indemnification for the assets transferred to us at the time of our initial public offering in 2004 and an additional \$2.5 million for the Intermediate Pipelines acquired in July 2005 for a period of up to ten years following our initial public offering in 2004. The indemnification relates to environmental noncompliance and

Table of Contents

remediation liabilities associated with the assets acquired from Holly that occurred or existed prior to our acquisition. We also 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 February 2005, where Alon will indemnify us for ten years subject to a \$100,000 deductible and a \$20.0 million maximum liability cap.

Contamination resulting from spills of refined products and crude oil is not unusual within the petroleum pipeline industry. Historic spills along our existing pipelines and terminals as a result of past operations have resulted in contamination of the environment, including soils and groundwater. Site conditions, including soils and groundwater, are being evaluated at a few of our properties where operations may have resulted in releases of hydrocarbons and other wastes, none of which we believe will have a significant effect on our operations as they would be covered under an environmental indemnification agreement.

An environmental remediation project is in progress currently at our El Paso terminal, the remaining costs of which are projected to be \$1.8 million over the next four years. Other parties are undertaking remediation projects at our Boise, Burley and Albuquerque terminals, and we are obligated to pay a portion of these costs at the Albuquerque terminal, but not at the Boise or Burley terminals. As of March 31, 2008, we estimate the total remaining remediation cost for the Albuquerque terminal to be insignificant. A remediation project is also under way in New Mexico concerning a leak at a point along our refined product pipeline from Artesia, New Mexico to Orla, Texas. As of March 31, 2008, we estimate the remaining cost on this project to be \$0.2 million.

There are four environmental remediation projects that are currently underway that pertain to the Crude Pipelines and Tankage Assets acquired from Holly. These projects relate to releases of oil into the environment that were already in progress and occurred prior to our purchase of the assets. Under the provisions of our purchase agreement, Holly has retained liability for these remediation projects, currently estimated to be \$0.9 million.

The Holly indemnification will cover the costs associated with the remediation projects mentioned above, including assessment, monitoring, and remediation programs.

We may experience future releases into the environment from our pipelines and terminals, or discover historical releases that were previously unidentified or not assessed. Although we maintain an extensive inspection and audit program designed, as applicable, to prevent, detect and address these releases promptly, damages and liabilities incurred due to any future environmental releases from our assets nevertheless have the potential to substantially affect our business.

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 U.S. GAAP. 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. We consider the following 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.

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, 2007. 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 assessing contingent liabilities for probable losses. There have been no changes to these policies in 2008.

Recent Accounting Pronouncements

Statement of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements

In September 2006, the Financial Accounting Standards Board issued SFAS No. 157, Fair Value Measurements. This standard simplifies and codifies guidance on fair value measurements under generally accepted accounting principles. This standard defines fair value, establishes a framework for measuring fair value and prescribes expanded disclosures about fair value measurements. It also establishes a fair value hierarchy that categorizes inputs used in fair value measurements into three broad levels. Under this hierarchy, quoted prices in active markets for identical assets or liabilities are considered the most reliable evidence of fair value and are given the highest priority level (level 1).

Unobservable inputs are considered the least reliable and are given the lowest priority level (level 3). We adopted this standard effective January 1, 2008.

We have interest rate swaps that we measure at fair value on a recurring basis using level 2 inputs. See Note 5 for additional information on these swaps.

- 37 -

Table of Contents*SFAS No. 133 Implementation Issue No. E23 Issues Involving the Application of the Shortcut Method under Paragraph 68*

In January 2008, the FASB posted SFAS No. 133 Implementation Issue No. E23, Issues Involving the Application of the Shortcut Method under Paragraph 68. This standard addresses issues pertaining to the application of the shortcut method in accounting for hedges when the settlement of a hedged item occurs subsequent to the interest rate swap trade date. It also addresses hedging relationships when the transaction price of an interest rate swap is zero. This standard is effective for hedging relationships designated on or after January 1, 2008 and requires the reassessment of preexisting hedges utilizing the shortcut method under this new guidance. We adopted this standard effective January 1, 2008. The adoption of this standard did not have a material impact on our financial condition, results of operations and cash flows.

RISK MANAGEMENT

As of March 31, 2008, we have two interest rate swap contracts.

We entered into an interest rate swap to hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on the \$171.0 million Credit Agreement advance that we used to finance our purchase of the Crude Pipelines and Tankage Assets from Holly. This interest rate swap effectively converts our \$171.0 million LIBOR based debt to fixed rate debt having an interest rate of 3.74% plus an applicable margin, currently 1.50% that results in a March 31, 2008 effective interest rate of 5.24%.

Under the provisions of SFAS No. 133, we have designated this interest rate swap as a cash flow hedge. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that this interest rate swap is effective in offsetting the variability in interest payments on our \$171.0 million variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our cash flow hedge on a quarterly basis to its fair value with a corresponding offset to accumulated other comprehensive income. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest payments on the variable leg of our swap against the expected future interest payments on our \$171.0 million variable rate debt. Any ineffectiveness is reclassified from accumulated other comprehensive income to interest expense. As of March 31, 2008, we had no ineffectiveness on our cash flow hedge.

We also have an interest rate swap contract that effectively converts interest expense associated with \$60.0 million of our 6.25% Senior Notes from a fixed to a variable rate. Under this swap contract, interest on the \$60.0 million notional amount is computed using the three-month LIBOR plus an applicable margin of 1.1575%, which equaled an effective interest rate of 4.23% at March 31, 2008. The maturity of the swap contract is March 1, 2015, matching the maturity of the Senior Notes.

This interest rate swap has been designated as a fair value hedge and meets the requirements to assume no ineffectiveness under the provisions of SFAS No. 133. Accordingly, we use the shortcut method of accounting as prescribed under SFAS No. 133. Under this method, we adjust the carrying value of the swap to its fair value on a quarterly basis, with an offsetting entry to our Senior Notes, effectively adjusting the carrying value of \$60.0 million of principal on the Senior notes to its fair value.

We record interest expense equal to the variable rate payments under the swaps. Receipts under the swap agreements are recorded as a reduction of interest expense.

Table of Contents

Additional information on our interest rate swaps are as follows:

Interest Rate Swaps	Balance Sheet Location	Fair Value (In thousands)	Location of Offsetting Balance
Cash flow hedge LIBOR based debt	\$171 million Other long-term liabilities	\$4,349	Accumulated other comprehensive loss
Fair value hedge of 6.25% Senior Notes	\$60 million Other assets	\$2,959	Long-term debt

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

At March 31, 2008, we had an outstanding principal balance on our unsecured Senior Notes of \$185.0 million. By means of our interest rate swap contract, we have effectively converted \$60.0 million of the Senior Notes from a fixed rate to variable rate. For the fixed rate debt portion of \$125.0 million, changes in interest rates would generally affect the fair value of the debt, but not our earnings or cash flows. Conversely, for the variable rate debt portion of \$60.0 million, changes in interest rates would generally not impact the fair value of the debt, but may affect our future earnings and cash flows. We estimate a hypothetical 10% change in the yield-to-maturity applicable to our fixed rate debt portion of \$125.0 million as of March 31, 2008 would result in a change of approximately \$4.9 million in the fair value of the debt. A hypothetical 10% change in the interest rate applicable to our variable rate debt portion of \$60.0 million would not have a material effect on our earnings or cash flows.

At March 31, 2008, 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 to any significant degree 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 formed 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.

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risks

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. We utilize derivative instruments to hedge our interest rate exposure, also 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 Exchange Act Rule 13a-15(e)) as of the end of the period covered by this quarterly report on Form 10-Q. Based on that evaluation, the principal executive officer and principal financial officer concluded that the design and operation of our disclosure controls and procedures are effective in ensuring that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms.

(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 been materially affected or are reasonably likely to materially affect our internal control over financial reporting.

- 40 -

Table of Contents

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 2. Unregistered Sales of Securities and Use of Proceeds**(c) Common unit repurchases made in the quarter**

In the first quarter of 2008, we paid \$0.5 million for the purchase of 13,273 of our common units in the open market for the recipients of our 2008 restricted unit grants.

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
January 2008		\$		
February 2008		\$		
March 2008	13,273	\$ 38.74		
Total	13,273	\$ 38.74		

Item 6. Exhibits

- 2.1 Purchase and Sale Agreement, dated February 25, 2008 between Holly Corporation, Navajo Pipeline Co., L.P., Navajo Refining Company, L.L.C., Woods Cross Refining Company, L.L.C., Holly Energy Partners, L.P., Holly Energy Partners Operating, L.P., HEP Pipeline, L.L.C., and HEP Woods Cross, L.L.C. (incorporated by reference to Exhibit 2.1 of Registrant's Form 8-K Current Report dated February 27, 2008, File No. 1-32225).
- 10.1 Option Agreement, dated January 31, 2008, by and among Holly Corporation, Holly UNEV Pipeline Company, Navajo Pipeline Co., L.P., Holly Logistic Services, L.L.C., HEP Logistics Holdings, L.P., Holly Energy Partners, L.P., HEP Logistics GP, L.L.C. and Holly Energy Partners Operating, L.P. (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K Current Report dated February 5, 2008, File No. 1-32225).
- 10.2 Agreement and Amendment No. 1 to Amended and Restated Credit Agreement, dated February 25, 2008, between Holly Energy Partners Operating, L.P., Union Bank of California, N.A., as administrative agent, issuing bank and sole lead arranger and certain other lenders (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K Current Report dated February 27, 2008, File No. 1-32225).
- 10.3 Pipelines and Tankage Agreement, dated February 29, 2008, between Holly Corporation, Navajo Pipeline Co., L.P., Navajo Refining Company, L.L.C., Woods Cross Refining Company, L.L.C., Holly Energy Partners, L.P., Holly Energy Partners Operating, L.P., HEP Pipeline, L.L.C., and HEP Woods Cross,

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L.L.C. (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).

- 10.4 Mortgage, Line of Credit Mortgage and Deed of Trust, dated February 29, 2008, by HEP Pipeline, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).

- 41 -

Table of Contents

- 10.5 Mortgage, Line of Credit Mortgage and Deed of Trust, dated February 29, 2008, by HEP Pipeline, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.3 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).
- 10.6 Mortgage, Line of Credit Mortgage and Deed of Trust, dated February 29, 2008, by HEP Pipeline, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.4 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).
- 10.7 Mortgage and Deed of Trust, dated February 29, 2008, by HEP Pipeline, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.5 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).
- 10.8 Mortgage and Deed of Trust, dated February 29, 2008, by HEP Pipeline, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.6 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).
- 10.9 Fee and Leasehold Deed of Trust, dated February 29, 2008, by HEP Woods Cross, L.L.C. for the benefit of Holly Corporation (incorporated by reference to Exhibit 10.7 of Registrant's Form 8-K Current Report dated March 6, 2008, File No. 1-32225).
- 10.10+ Holly Energy Partners, L.P. Employee Form of Change in Control Agreement (incorporated by reference to Exhibit 10.3 of Registrant's Form 8-K Current Report dated February 20, 2008, File No. 1-32225).
- 12.1* Computation of Ratio of Earnings to Fixed Charges.
- 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.
- 32.2* Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.

* Filed herewith

+ Constitutes
management
contracts or
compensatory
plans or
arrangements.

Table of Contents

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: May 2, 2008

/s/ Bruce R. Shaw

Bruce R. Shaw
Senior Vice President and
Chief Financial Officer
(Principal Financial Officer and
Principal Accounting Officer)

- 43 -