

W R GRACE & CO  
Form 4  
May 12, 2014

**FORM 4**

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

Check this box  
if no longer  
subject to  
Section 16.  
Form 4 or  
Form 5  
obligations  
may continue.  
See Instruction  
1(b).

**STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF  
SECURITIES**

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934,  
Section 17(a) of the Public Utility Holding Company Act of 1935 or Section  
30(h) of the Investment Company Act of 1940

## OMB APPROVAL

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Number: 3235-0287  
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2005  
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(Print or Type Responses)

1. Name and Address of Reporting Person \*  
FESTA ALFRED E

(Last) (First) (Middle)

C/O W. R. GRACE & CO., 7500  
GRACE DRIVE

(Street)

COLUMBIA, MD 21044

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading  
Symbol  
W R GRACE & CO [GRA]

3. Date of Earliest Transaction  
(Month/Day/Year)  
05/08/2014

4. If Amendment, Date Original  
Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to  
Issuer

(Check all applicable)

☒ Director ☐ 10% Owner  
☒ Officer (give title below) ☐ Other (specify  
below)

Chairman and CEO

6. Individual or Joint/Group Filing(Check  
Applicable Line)  
☒ Form filed by One Reporting Person  
☐ Form filed by More than One Reporting  
Person

**Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned**

| 1. Title of<br>Security<br>(Instr. 3) | 2. Transaction Date<br>(Month/Day/Year) | 2A. Deemed<br>Execution Date, if<br>any<br>(Month/Day/Year) | 3. Transaction<br>Code<br>(Instr. 8) | 4. Securities<br>Acquired (A) or<br>Disposed of (D)<br>(Instr. 3, 4 and 5) | 5. Amount of<br>Securities<br>Beneficially<br>Owned<br>Following<br>Reported<br>Transaction(s)<br>(Instr. 3 and 4) | 6. Ownership<br>Form: Direct<br>(D) or Indirect<br>(I)<br>(Instr. 4) | 7. Nature of<br>Indirect<br>Beneficial<br>Ownership<br>(Instr. 4) |
|---------------------------------------|---|---|--------------------------------------|--|--|--|---|
|                                       |   |   |                                      | (A)<br>or<br>(D)   |  |  |   |
|                                       |   |   | Code                                 | V  | Amount   |  | Price   |

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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number.**

SEC 1474  
(9-02)

**Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned**  
**(e.g., puts, calls, warrants, options, convertible securities)**

| 1. Title of<br>Derivative<br>Security | 2. Conversion<br>or Exercise | 3. Transaction Date<br>(Month/Day/Year) | 3A. Deemed<br>Execution Date, if<br>any | 4. Transaction<br>Code | 5. Number of<br>Derivative<br>Securities | 6. Date Exercisable and<br>Expiration Date<br>(Month/Day/Year) | 7. Title and Amount of<br>Underlying Securities<br>(Instr. 3 and 4) |
|---------------------------------------|------------------------------|---|---|------------------------|--|--|---|
|                                       |                              |   |   |                        |  |  |   |

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| (Instr. 3)   | Price of<br>Derivative<br>Security | (Month/Day/Year)          | (Instr. 8) | Acquired (A)<br>or Disposed of<br>(D)<br>(Instr. 3, 4,<br>and 5) | Code | V | (A)    | (D) | Date<br>Exercisable | Expiration<br>Date | Title           | Amount<br>or<br>Number<br>of Shares |
|--|------------------------------------|---------------------------|------------|--|------|---|--------|-----|---------------------|--------------------|-----------------|-------------------------------------|
| Employee<br>Stock<br>Options<br>(rights to<br>buy) | \$ 92.77                           | 05/08/2014 <sup>(1)</sup> |            |  | A    |   | 91,624 |     | <sup>(2)</sup>      | 05/08/2019         | Common<br>Stock | 91,624                              |

## Reporting Owners

| Reporting Owner Name / Address  | Relationships |           |                  |       |
|---|---------------|-----------|------------------|-------|
|   | Director      | 10% Owner | Officer          | Other |
| FESTA ALFRED E<br>C/O W. R. GRACE & CO.<br>7500 GRACE DRIVE<br>COLUMBIA, MD 21044 | X             |           | Chairman and CEO |       |

## Signatures

/s/ Michael W. Conron,  
Attorney-in-Fact

05/12/2014

\_\_Signature of Reporting Person

Date

## Explanation of Responses:

\* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

\*\* Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

(1) Granted at a regularly scheduled Compensation Committee meeting on May 8, 2014.

(2) Options become exercisable in three substantially equal annual installments beginning on May 8, 2015; May 6, 2016; and May 8, 2017.

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.

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888 21,489 22,377

Operating income (loss)

(888) 25,060 24,172

Equity in earnings of subsidiaries

23,285 (23,285)

Equity in earnings of SLC Pipeline

570 570

Interest income (expense)

(6,138) (2,278) (8,416)

Other

9 9

17,147 (1,699) (23,285) (7,837)

Income (loss) before income taxes

16,259 23,361 (23,285) 16,335

State income tax

(76) (76)

Net income

\$16,259 \$23,285 \$(23,285) \$16,259

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

| <b>Nine months Ended September 30, 2011</b> | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries<br/>(In thousands)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|--|---------------------|---------------------|
| <b>Revenues:</b>                            |               |  |                     |                     |
| Affiliates                                  | \$            | \$ 112,192   | \$                  | \$ 112,192          |
| Third parties                               |               | 33,033   |                     | 33,033              |
|   |               | 145,225  |                     | 145,225             |
| <b>Operating costs and expenses:</b>        |               |  |                     |                     |
| Operations                                  |               | 41,851   |                     | 41,851              |
| Depreciation and amortization               |               | 23,086   |                     | 23,086              |
| General and administrative                  | 2,869         | 2,079  |                     | 4,948               |
|   | 2,869         | 67,016   |                     | 69,885              |
| Operating income (loss)                     | (2,869)       | 78,209   |                     | 75,340              |
| Equity in earnings of subsidiaries          | 72,167        |  | (72,167)            |                     |
| Equity in earnings of SLC Pipeline          |               | 1,848  |                     | 1,848               |
| Interest income (expense)                   | (18,372)      | (7,729)  |                     | (26,101)            |
| Other                                       |               | 8  |                     | 8                   |
|   | 53,795        | (5,873)  | (72,167)            | (24,245)            |
| Income before income taxes                  | 50,926        | 72,336   | (72,167)            | 51,095              |
| State income tax benefit (expense)          |               | (169)  |                     | (169)               |
| Net income                                  | \$ 50,926     | \$ 72,167  | \$ (72,167)         | \$ 50,926           |

**Condensed Consolidating Statement of Income**

| <b>Nine months Ended September 30, 2010</b> | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries<br/>(In thousands)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|--|---------------------|---------------------|
| <b>Revenues:</b>                            |               |  |                     |                     |
| Affiliates                                  | \$            | \$ 107,989   | \$                  | \$ 107,989          |
| Third parties                               |               | 24,739   |                     | 24,739              |
|   |               | 132,728  |                     | 132,728             |
| <b>Operating costs and expenses:</b>        |               |  |                     |                     |
| Operations                                  |               | 40,187   |                     | 40,187              |
| Depreciation and amortization               |               | 22,038   |                     | 22,038              |
| General and administrative                  | 3,970         | 2,014  |                     | 5,984               |
|   | 3,970         | 64,239   |                     | 68,209              |
| Operating income (loss)                     | (3,970)       | 68,489   |                     | 64,519              |

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|                                    |           |           |             |           |
|------------------------------------|-----------|-----------|-------------|-----------|
| Equity in earnings of subsidiaries | 61,603    |           | (61,603)    |           |
| Equity in earnings of SLC Pipeline |           | 1,595     |             | 1,595     |
| Interest income (expense)          | (17,237)  | (8,267)   |             | (25,504)  |
| Other                              |           | 2         |             | 2         |
|                                    | 44,366    | (6,670)   | (61,603)    | (23,907)  |
| Income before income taxes         | 40,396    | 61,819    | (61,603)    | 40,612    |
| State income tax                   |           | (216)     |             | (216)     |
| Net income                         | \$ 40,396 | \$ 61,603 | \$ (61,603) | \$ 40,396 |

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

| <b>Nine months Ended September 30, 2011</b> | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries<br/>(In thousands)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|--|---------------------|---------------------|
| Cash flows from operating activities        | \$ 69,604     | \$ (6,958)   | \$                  | \$ 62,646           |
| Cash flows from investing activities        |               |  |                     |                     |
| Additions to properties and equipment       |               | (31,493)   |                     | (31,493)            |
| Cash flows from financing activities        |               |  |                     |                     |
| Net borrowings under credit agreement       |               | 43,000   |                     | 43,000              |
| Distributions to HEP unitholders            | (67,963)      |  |                     | (67,963)            |
| Purchase of units for restricted grants     | (1,641)       |  |                     | (1,641)             |
| Deferred financing costs                    |               | (3,150)  |                     | (3,150)             |
|   | (69,604)      | 39,850   |                     | (29,754)            |
| Cash and cash equivalents                   |               |  |                     |                     |
| Increase for the period                     |               | 1,399  |                     | 1,399               |
| Beginning of period                         | 2             | 401  |                     | 403                 |
| End of period                               | \$ 2          | \$ 1,800   | \$                  | \$ 1,802            |

**Condensed Consolidating Statement of Cash Flows**

| <b>Nine months Ended September 30, 2010</b>                               | <b>Parent</b> | <b>Guarantor<br/>Subsidiaries<br/>(in thousands)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|---------------|--|---------------------|---------------------|
| Cash flows from operating activities                                      | \$ (82,123)   | \$ 148,252   | \$                  | \$ 66,129           |
| Cash flows from investing activities                                      |               |  |                     |                     |
| Additions to properties and equipment                                     |               | (8,054)  |                     | (8,054)             |
| Acquisition of assets from HFC  |               | (35,526)   |                     | (35,526)            |
|   |               | (43,580)   |                     | (43,580)            |
| Cash flows from financing activities                                      |               |  |                     |                     |
| Net repayments under credit agreement                                     |               | (49,000)   |                     | (49,000)            |
| Net proceeds from issuance of senior notes                                | 147,540       |  |                     | 147,540             |
| Distributions to HEP unitholders  | (62,648)      |  |                     | (62,648)            |
| Purchase price in excess of transferred basis in assets acquired from HFC |               | (57,474)   |                     | (57,474)            |
| Purchase of units for restricted grants                                   | (2,276)       |  |                     | (2,276)             |
| Deferred financing costs  | (493)         |  |                     | (493)               |
|   | 82,123        | (106,474)  |                     | (24,351)            |
| Cash and cash equivalents   |               |  |                     |                     |
| Decrease for the period   |               | (1,802)  |                     | (1,802)             |
| Beginning of period   | 2             | 2,506  |                     | 2,508               |
| End of period   | \$ 2          | \$ 704   | \$                  | \$ 706              |





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**HOLLY ENERGY PARTNERS, L.P.**

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

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

**OVERVIEW**

HEP is a Delaware limited partnership. We own and operate petroleum product and crude oil pipeline and terminal, tankage and loading rack facilities that support the refining and marketing operations of HollyFrontier Corporation (formerly known as Holly Corporation) ( HFC ) in west Texas, New Mexico, Utah, Oklahoma, Idaho and Arizona. HFC and its subsidiaries currently own a 34% interest in us including the 2% general partnership interest. HFC changed its name in connection with the consummation of its merger of equals with Frontier Oil Corporation effective July 1, 2011. All previous references to Holly within this document have been replaced with HFC.

We also own and operate refined product pipelines and terminals, located primarily in Texas, that service Alon's ( Alon ) Big Spring refinery in Big Spring, Texas. Additionally, we own a 25% joint venture interest in the SLC Pipeline (the SLC Pipeline ), a 95-mile intrastate crude oil pipeline system that serves refineries in the Salt Lake City area.

We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling refined products and other hydrocarbons and storing and providing other services at our storage tanks and terminals. We do not take ownership of products that we transport, terminal or store, and therefore, we are not directly exposed to changes in commodity prices.

**Pending 2011 Acquisition**

***Legacy Frontier Pipeline and Tankage Asset Transaction***

We have announced an agreement in principle with HFC, subject to the execution of definitive agreements and certain closing conditions, for the acquisition of certain pipeline, tankage, loading rack and crude receiving assets located at HFC's El Dorado and Cheyenne refineries for \$340 million. The purchase price is expected to be paid in promissory notes with an aggregate original principal amount of \$150 million and we will issue HFC an additional number of our common units having a value equal to the remaining \$190 million purchase price.

In connection with the proposed transaction, we intend to enter into 15-year throughput agreements with HFC in November 2011 containing minimum annual revenue commitments that we project will result in \$47 million of incremental annual revenue.

We are a consolidated variable interest entity of HFC. Therefore, in accounting for this proposed transaction, we will record the assets at HFC's cost basis.

**2010 Acquisitions**

***Tulsa East / Lovington Storage Asset Transaction***

On March 31, 2010, we acquired from HFC certain storage assets for \$93 million, consisting of hydrocarbon storage tanks having approximately 2 million barrels of storage capacity, a rail loading rack and a truck unloading rack located at HFC's Tulsa refinery east facility and an asphalt loading rack facility located at HFC's Navajo refinery facility in Lovington, New Mexico.

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### ***Agreements with HFC and Alon***

We serve HFC's refineries in New Mexico, Utah and Oklahoma under the following long-term pipeline and terminal, tankage and throughput agreements:

HFC PTA (pipelines and terminals throughput agreement expiring in 2019 that relates to assets contributed to us by HFC upon our initial public offering in 2004);

HFC IPA (intermediate pipelines throughput agreement expiring in 2024 that relates to assets acquired from HFC in 2005 and 2009);

HFC CPTA (crude pipelines and tankage throughput agreement expiring in 2023 that relates to assets acquired from HFC in 2008);

HFC PTTA (pipeline, tankage and loading rack throughput agreement expiring in 2024 that relates to the Tulsa east facilities acquired from Sinclair in 2009 and from HFC in March 2010 and our Tulsa interconnect pipelines);

HFC RPA (pipeline throughput agreement expiring in 2024 that relates to the Roadrunner Pipeline acquired from HFC in 2009);

HFC ETA (equipment and throughput agreement expiring in 2024 that relates to the Tulsa west facilities acquired from HFC in 2009);

HFC NPA (natural gas pipeline throughput agreement expiring in 2024); and

HFC ATA (asphalt loading rack throughput agreement expiring in 2025 that relates to the Lovington rack facility acquired from HFC in March 2010).

In August 2011, we and HFC amended the HFC PTTA to provide throughput services via our interconnect pipelines. The amendment provides for the transportation of intermediate products between HFC's Tulsa east and west refining facilities and will result in minimum incremental annual revenues of \$4.9 million.

Under these agreements, HFC agreed to transport, store and throughput volumes of refined product and crude oil on our pipelines and terminal, tankage and loading rack facilities that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual tariff rate adjustments on July 1, based on the Producer Price Index ( PPI ) or Federal Energy Regulatory Commission ( FERC ) index. As of September 30, 2011, these agreements with HFC will result in minimum annualized payments to us of \$145 million.

We also have a pipelines and terminals agreement with Alon expiring in 2020 under which Alon has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that result in a minimum level of annual revenue that also is subject to annual tariff rate adjustments.

We have a capacity lease agreement with Alon under which we lease Alon space on our Orla to El Paso pipeline for the shipment of up to 17,500 barrels of refined product per day. The terms under this agreement expire beginning in 2012 through 2018.

As of September 30, 2011, contractual minimums under our long-term service agreements are as follows:

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| <b>Agreement</b>    | <b>Minimum<br/>Annualized<br/>Commitment<br/>(In millions)</b> | <b>Year of<br/>Maturity</b> | <b>Contract Type</b>       |
|---------------------|--|-----------------------------|----------------------------|
| HFC PTA             | \$ 45.6  | 2019                        | Minimum revenue commitment |
| HFC IPA             | 21.5   | 2024                        | Minimum revenue commitment |
| HFC CPTA            | 29.8   | 2023                        | Minimum revenue commitment |
| HFC PTTA            | 34.7   | 2024                        | Minimum revenue commitment |
| HFC RPA             | 9.5  | 2024                        | Minimum revenue commitment |
| HFC ETA             | 2.8  | 2024                        | Minimum revenue commitment |
| HFC ATA             | 0.5  | 2025                        | Minimum revenue commitment |
| HFC NPA             | 0.6  | 2024                        | Minimum revenue commitment |
| Alon PTA            | 23.4   | 2020                        | Minimum volume commitment  |
| Alon capacity lease | 6.6  | Various                     | Capacity lease             |
| <b>Total</b>        | <b>\$ 175.0</b>  |                             |                            |

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

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

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**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 and the nine months ended September 30, 2011 and 2010.

|   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Change<br/>from<br/>2010</b> |
|---|---|-------------|---------------------------------|
|   | <b>2011</b>                                 | <b>2010</b> |                                 |
| (In thousands, except per unit data)  |   |             |                                 |
| <b>Revenues</b>   |   |             |                                 |
| Pipelines:  |   |             |                                 |
| Affiliates refined product pipelines  | \$ 12,937                                   | \$ 12,340   | \$ 597                          |
| Affiliates intermediate pipelines   | 5,935                                       | 4,917       | 1,018                           |
| Affiliates crude pipelines  | 10,555                                      | 9,775       | 780                             |
|   | 29,427                                      | 27,032      | 2,395                           |
| Third parties refined product pipelines   | 6,525                                       | 7,277       | (752)                           |
|   | 35,952                                      | 34,309      | 1,643                           |
| Terminals, tanks and loading racks:   |   |             |                                 |
| Affiliates  | 11,519                                      | 10,281      | 1,238                           |
| Third parties   | 1,797                                       | 1,959       | (162)                           |
|   | 13,316                                      | 12,240      | 1,076                           |
| Total revenues  | 49,268                                      | 46,549      | 2,719                           |
| <b>Operating costs and expenses</b>   |   |             |                                 |
| Operations  | 14,689                                      | 13,632      | 1,057                           |
| Depreciation and amortization   | 7,733                                       | 7,237       | 496                             |
| General and administrative  | 2,012                                       | 1,508       | 504                             |
|   | 24,434                                      | 22,377      | 2,057                           |
| <b>Operating income</b>   | 24,834                                      | 24,172      | 662                             |
| Equity in earnings of SLC Pipeline  | 641   | 570         | 71                              |
| Interest income   |   | 1           | (1)                             |
| Interest expense, including amortization  | (8,828)                                     | (8,417)     | (411)                           |
| Other   | 20  | 9           | 11                              |
|   | (8,167)                                     | (7,837)     | (330)                           |
| <b>Income before income taxes</b>   | 16,667                                      | 16,335      | 332                             |
| State income tax  | 77  | (76)        | 153                             |
| <b>Net income</b>   | 16,744                                      | 16,259      | 485                             |
| Less general partner interest in net income, including incentive distributions <sup>(1)</sup> | 4,009                                       | 3,172       | 837                             |
| <b>Limited partners interest in net income</b>  | \$ 12,735                                   | \$ 13,087   | \$ (352)                        |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| <b>Limited partners earnings per unit basic and diluted<sup>(1)</sup></b> | \$ 0.58   | \$ 0.59   | \$ (0.01) |
| <b>Weighted average limited partners units outstanding</b>                | 22,079    | 22,079    |           |
| <b>EBITDA<sup>(2)</sup></b>   | \$ 33,228 | \$ 31,988 | \$ 1,240  |
| <b>Distributable cash flow<sup>(3)</sup></b>                              | \$ 25,731 | \$ 23,969 | \$ 1,762  |
| <b>Volumes (bpd)</b>  |           |           |           |
| <b>Pipelines:</b>   |           |           |           |
| Affiliates refined product pipelines                                      | 96,105    | 93,194    | 2,911     |
| Affiliates intermediate pipelines   | 91,783    | 83,227    | 8,556     |
| Affiliates crude pipelines  | 175,459   | 143,617   | 31,842    |
|   | 363,347   | 320,038   | 43,309    |
| Third parties refined product pipelines                                   | 44,212    | 41,967    | 2,245     |
|   | 407,559   | 362,005   | 45,554    |
| <b>Terminals and loading racks:</b>                                       |           |           |           |
| Affiliates  | 183,987   | 183,312   | 675       |
| Third parties   | 43,224    | 43,633    | (409)     |
|   | 227,211   | 226,945   | 266       |
| <b>Total for pipelines and terminal assets (bpd)</b>                      | 634,770   | 588,950   | 45,820    |

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|   | Nine Months Ended<br>September 30, |           | Change<br>from<br>2010 |
|---|------------------------------------|-----------|------------------------|
|   | 2011                               | 2010      |                        |
| (In thousands, except per unit data)  |                                    |           |                        |
| <b>Revenues</b>   |                                    |           |                        |
| Pipelines:  |                                    |           |                        |
| Affiliates refined product pipelines  | \$ 34,484                          | \$ 35,887 | \$ (1,403)             |
| Affiliates intermediate pipelines   | 15,637                             | 15,673    | (36)                   |
| Affiliates crude pipelines  | 29,500                             | 28,907    | 593                    |
|   | 79,621                             | 80,467    | (846)                  |
| Third parties refined product pipelines   | 27,586                             | 19,136    | 8,450                  |
|   | 107,207                            | 99,603    | 7,604                  |
| Terminals, tanks and loading racks:   |                                    |           |                        |
| Affiliates  | 32,571                             | 27,522    | 5,049                  |
| Third parties   | 5,447                              | 5,603     | (156)                  |
|   | 38,018                             | 33,125    | 4,893                  |
| Total revenues  | 145,225                            | 132,728   | 12,497                 |
| <b>Operating costs and expenses</b>   |                                    |           |                        |
| Operations  | 41,851                             | 40,187    | 1,664                  |
| Depreciation and amortization   | 23,086                             | 22,038    | 1,048                  |
| General and administrative  | 4,948                              | 5,984     | (1,036)                |
|   | 69,885                             | 68,209    | 1,676                  |
| <b>Operating income</b>   | 75,340                             | 64,519    | 10,821                 |
| Equity in earnings of SLC Pipeline  | 1,848                              | 1,595     | 253                    |
| Interest income   |                                    | 6         | (6)                    |
| Interest expense, including amortization  | (26,101)                           | (25,510)  | (591)                  |
| Other   | 8                                  | 2         | 6                      |
|   | (24,245)                           | (23,907)  | (338)                  |
| <b>Income before income taxes</b>   | 51,095                             | 40,612    | 10,483                 |
| State income tax  | (169)                              | (216)     | 47                     |
| <b>Net income</b>   | 50,926                             | 40,396    | 10,530                 |
| Less general partner interest in net income, including incentive distributions <sup>(1)</sup> | 11,418                             | 8,727     | 2,691                  |
| <b>Limited partners interest in net income</b>  | \$ 39,508                          | \$ 31,669 | \$ 7,839               |
| <b>Limited partners earnings per unit basic and diluted <sup>(1)</sup></b>                    | \$ 1.79                            | \$ 1.43   | \$ 0.36                |
| <b>Weighted average limited partners units outstanding</b>                                    | 22,079                             | 22,079    |                        |
| <b>EBITDA <sup>(2)</sup></b>  | \$ 100,282                         | \$ 88,154 | \$ 12,128              |
| <b>Distributable cash flow <sup>(3)</sup></b>   | \$ 67,924                          | \$ 66,800 | \$ 1,124               |
| <b>Volumes (bpd)</b>  |                                    |           |                        |



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|  |                           |                |                |               |
|--|---------------------------|----------------|----------------|---------------|
| Pipelines:   |                           |                |                |               |
| Affiliates   | refined product pipelines | 88,172         | 95,013         | (6,841)       |
| Affiliates   | intermediate pipelines    | 81,618         | 82,844         | (1,226)       |
| Affiliates   | crude pipelines           | 157,598        | 139,955        | 17,643        |
|  |                           | 327,388        | 317,812        | 9,576         |
| Third parties  | refined product pipelines | 48,107         | 35,923         | 12,184        |
|  |                           | 375,495        | 353,735        | 21,760        |
| Terminals and loading racks:                         |                           |                |                |               |
| Affiliates   |                           | 174,866        | 177,946        | (3,080)       |
| Third parties  |                           | 42,102         | 38,825         | 3,277         |
|  |                           | 216,968        | 216,771        | 197           |
| <b>Total for pipelines and terminal assets (bpd)</b> |                           | <b>592,463</b> | <b>570,506</b> | <b>21,957</b> |

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- (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 incentive distributions declared subsequent to quarter end. Net income attributable to the limited partners is divided by the weighted average limited partner units outstanding in computing the limited partners per unit interest in net income.
- (2) EBITDA is calculated as net income plus (i) interest expense, net of interest income, (ii) state income tax and (iii) depreciation and amortization. EBITDA is not a calculation based upon U.S. generally accepted accounting principles ( GAAP ). However, the amounts included in the EBITDA calculation are derived from amounts included in our consolidated financial statements. EBITDA should not be considered as an alternative to net income or operating income, as an indication of our operating performance or as an alternative to operating cash flow as a measure of liquidity. EBITDA is not necessarily comparable to similarly titled measures of other companies. EBITDA is presented here because it is a widely used financial indicator used by investors and analysts to measure performance. EBITDA also is used by our management for internal analysis and as a basis for compliance with financial covenants.

Set forth below is our calculation of EBITDA.

|  | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|--|-------------------------------------|------------------|------------------------------------|------------------|
|  | 2011                                | 2010             | 2011                               | 2010             |
|  | (In thousands)                      |                  |                                    |                  |
| <b>Net income</b>  | \$ 16,744                           | \$ 16,259        | \$ 50,926                          | \$ 40,396        |
| Add (subtract):  |                                     |                  |                                    |                  |
| Interest expense   | 8,520                               | 8,135            | 25,198                             | 22,230           |
| Amortization of discount and deferred debt issuance costs  | 308                                 | 282              | 903                                | 740              |
| Increase in interest expense change in fair value of interest rate swaps and swap settlement costs |                                     |                  |                                    | 2,540            |
| Interest income  |                                     | (1)              |                                    | (6)              |
| State income tax   | (77)                                | 76               | 169                                | 216              |
| Depreciation and amortization  | 7,733                               | 7,237            | 23,086                             | 22,038           |
| <b>EBITDA</b>  | <b>\$ 33,228</b>                    | <b>\$ 31,988</b> | <b>\$ 100,282</b>                  | <b>\$ 88,154</b> |

- (3) Distributable cash flow is not a calculation based upon GAAP. However, the amounts included in the calculation are derived from amounts separately presented in our consolidated financial statements, with the exception of equity in excess cash flows over earnings of SLC Pipeline, and 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. It is also used by management for internal analysis and for our performance units. We believe that this measure provides investors an enhanced perspective of the operating performance of our assets and the cash our business is generating.

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Set forth below is our calculation of distributable cash flow.

|  | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--|-------------------------------------|-----------|------------------------------------|-----------|
|  | 2011                                | 2010      | 2011                               | 2010      |
|  | (In thousands)                      |           |                                    |           |
| <b>Net income</b>  | \$ 16,744                           | \$ 16,259 | \$ 50,926                          | \$ 40,396 |
| Add (subtract):  |                                     |           |                                    |           |
| Depreciation and amortization  | 7,733                               | 7,237     | 23,086                             | 22,038    |
| Amortization of discount and deferred debt issuance costs  | 308                                 | 282       | 903                                | 740       |
| Increase in interest expense change in fair value of interest rate swaps and swap settlement costs |                                     |           |                                    | 2,540     |
| Equity in excess cash flows over earnings of SLC Pipeline  | 198                                 | 173       | 512                                | 525       |
| Increase (decrease) in deferred revenue  | 1,201                               | 758       | (3,917)                            | 3,279     |
| Maintenance capital expenditures*  | (453)                               | (740)     | (3,586)                            | (2,718)   |
| <b>Distributable cash flow</b>   | \$ 25,731                           | \$ 23,969 | \$ 67,924                          | \$ 66,800 |

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

|                                 | September 30,<br>2011 | December 31,<br>2010 |
|---------------------------------|-----------------------|----------------------|
|                                 | (In thousands)        |                      |
| <b>Balance Sheet Data</b>       |                       |                      |
| Cash and cash equivalents       | \$ 1,802              | \$ 403               |
| Working capital (deficit)       | \$ 7,587              | \$ (7,758)           |
| Total assets                    | \$ 657,703            | \$ 643,273           |
| Long-term debt                  | \$ 534,902            | \$ 491,648           |
| Partners' equity <sup>(4)</sup> | \$ 94,976             | \$ 109,372           |

(4) 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 have exceeded our quarterly net income. Additionally, if the assets contributed and acquired from HFC had occurred while we were not a consolidated variable interest entity of HFC, our acquisition cost in excess of HFC's historical basis in the transferred assets of \$218 million would have been recorded in our financial statements as increases to our properties and equipment and intangible assets instead of decreases to our partners' equity.

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### **Results of Operations Three Months Ended September 30, 2011 Compared with Three Months Ended September 30, 2010**

#### ***Summary***

Net income for the three months ended September 30, 2011 was \$16.7 million, a \$0.5 million increase compared to the three months ended September 30, 2010. This increase in overall earnings is due principally to an increase in overall pipeline shipments, revenues attributable to our Tulsa interconnect pipelines and annual tariff increases, net of the effects of a decrease in deferred revenue realized and increased operating costs and expenses.

Revenues for the three months ended September 30, 2011 include the recognition of \$0.8 million of prior shortfalls billed to shippers in 2010 as they did not meet their minimum volume commitments within the contractual make-up period. Revenues of \$2 million relating to deficiency payments associated with certain guaranteed shipping contracts were deferred during the three months ended September 30, 2011. Such deferred revenue will be recognized in earnings either as payment for shipments in excess of guaranteed levels, or when shipping rights expire unused.

#### ***Revenues***

Total revenues for the three months ended September 30, 2011 were \$49.3 million, a \$2.7 million increase compared to the three months ended September 30, 2010. This is due principally to increased pipeline shipments and the effect of annual tariff increases. These factors were partially offset by a \$0.8 million decrease in previously deferred revenue realized.

Revenues from our refined product pipelines were \$19.5 million, a decrease of \$0.2 million compared to the three months ended September 30, 2010. This reflects the effects of a \$1.1 million decrease in previously deferred revenue realized and an increase in refined product pipeline shipments. Volumes shipped on our refined product pipelines averaged 140.3 thousand barrels per day ( mbpd ) compared to 135.2 mbpd for the same period last year.

Revenues from our intermediate pipelines were \$5.9 million, an increase of \$1 million compared to the three months ended September 30, 2010. This reflects \$0.4 million in revenues attributable to the Tulsa interconnect pipelines and a \$0.3 million increase in previously deferred revenue realized combined with an increase in intermediate pipeline shipments. Volumes shipped on our intermediate pipelines averaged 91.8 mbpd compared to 83.2 mbpd for the same period last year.

Revenues from our crude pipelines were \$10.6 million, an increase of \$0.8 million compared to the three months ended September 30, 2010. Volumes shipped on our crude pipelines increased to an average of 175.5 mbpd compared to 143.6 mbpd for the same period last year.

Revenues from terminal, tankage and loading rack fees were \$13.3 million, an increase of \$1.1 million compared to the three months ended September 30, 2010. Refined products terminalled in our facilities increased to an average of 227.2 mbpd compared to 226.9 mbpd for the same period last year.

#### ***Operations Expense***

Operations expense for the three months ended September 30, 2011 increased by \$1.1 million compared to the three months ended September 30, 2010. This increase is due principally to higher maintenance services and payroll costs during the current year third quarter.

#### ***Depreciation and Amortization***

Depreciation and amortization for the three months ended September 30, 2011 increased by \$0.5 million compared to the three months ended September 30, 2010.

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### ***General and Administrative***

General and administrative costs for the three months ended September 30, 2011 increased by \$0.5 million compared to the three months ended September 30, 2010 due to professional fees and costs incurred in relation to our pending asset acquisition from HFC.

### ***Equity in Earnings of SLC Pipeline***

Our equity in earnings of the SLC Pipeline was \$0.6 million for the three months ended September 30, 2011 and 2010.

### ***Interest Expense***

Interest expense for the three months ended September 30, 2011 totaled \$8.8 million, an increase of \$0.4 million compared to the three months ended September 30, 2010. This increase reflects interest on increased debt levels during the current year third quarter. Our aggregate effective interest rate was 6.7% for the three months ended September 30, 2011 compared to 6.9% for the same period of 2010.

### ***State Income Tax***

We recorded state income taxes of \$(77,000) and \$76,000 for the three months ended September 30, 2011 and 2010, respectively, which are solely attributable to the Texas margin tax. The credit balance for the three months ended September 30, 2011 relates to a revision to estimated state income taxes.

## **Results of Operations Nine Months Ended September 30, 2011 Compared with Nine Months Ended September 30, 2010**

### ***Summary***

Net income for the nine months ended September 30, 2011 was \$50.9 million, a \$10.5 million increase compared to the nine months ended September 30, 2010. This increase in overall earnings is due principally to an overall increase in pipeline shipments, earnings attributable to our March 2010 asset acquisitions and an increase in previously deferred revenue realized. These factors were partially offset by an overall increase in operating costs and expenses.

Revenues for the nine months ended September 30, 2011 include the recognition of \$9.9 million of prior shortfalls billed to shippers in 2010. Revenues of \$6 million relating to deficiency payments associated with certain guaranteed shipping contracts were deferred during the nine months ended September 30, 2011. Such deferred revenue will be recognized in earnings either as payment for shipments in excess of guaranteed levels, or when shipping rights expire unused.

### ***Revenues***

Total revenues for the nine months ended September 30, 2011 were \$145.2 million, a \$12.5 million increase compared to the nine months ended September 30, 2010. This is due principally to an overall increase in pipeline shipments, revenues attributable to our March 2010 asset acquisitions, a \$4.1 million increase in previously deferred revenue realized and the effect of annual tariff increases. Overall pipeline shipments were up 6% from the nine months ended September 30, 2010, due to an increase in third-party refined product pipeline shipments.

Certain related-party pipeline and throughput volumes were down during the current year-to-date period as a result of downtime at HFC's Navajo refinery following a plant-wide power outage in late January 2011 and the subsequent delay in restoring production to planned levels.

Revenues from our refined product pipelines were \$62 million, an increase of \$7 million compared to the nine months ended September 30, 2010. This is due to a \$4.3 million increase in previously deferred revenue realized and an increase in third-party refined product pipeline shipments. Volumes shipped on our refined product pipelines averaged 136.2 mbpd compared to 130.9 mbpd for the same period last year.

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Revenues from our intermediate pipelines were \$15.6 million, equivalent to the nine months ended September 30, 2010. This reflects \$0.4 million in revenues attributable to the Tulsa interconnect pipelines offset by a \$0.2 million decrease in previously deferred revenue realized and a decrease in intermediate pipeline shipments. Shipments on our intermediate pipelines decreased to an average of 81.6 mbpd compared to 82.8 mbpd for the same period last year.

Revenues from our crude pipelines were \$29.5 million, an increase of \$0.6 million compared to the nine months ended September 30, 2010. Volumes on our crude pipelines averaged 157.6 mbpd compared to 140 mbpd for the same period last year.

Revenues from terminal, tankage and loading rack fees were \$38 million, an increase of \$4.9 million compared to the nine months ended September 30, 2010. This increase is due primarily to revenues attributable to our Tulsa storage and rack facilities acquired from HFC in March 2010. Refined products terminalled in our facilities increased to an average of 217 mbpd compared to 216.8 mbpd for the same period last year.

### ***Operations Expense***

Operations expense for the nine months ended September 30, 2011 increased by \$1.7 million compared to the nine months ended September 30, 2010. This increase is due principally to increased property taxes, maintenance services and payroll costs during the current year-to-date period.

### ***Depreciation and Amortization***

Depreciation and amortization for the nine months ended September 30, 2011 increased by \$1 million compared to the nine months ended September 30, 2010. This was due to increased depreciation attributable to our March 2010 asset acquisitions from HFC and capital projects.

### ***General and Administrative***

General and administrative costs for the nine months ended September 30, 2011 decreased by \$1 million compared to the nine months ended September 30, 2010, which included overall higher professional fees and costs as a result of our March 2010 asset acquisitions from HFC.

### ***Equity in Earnings of SLC Pipeline***

Our equity in earnings of the SLC Pipeline was \$1.8 million and \$1.6 million for the nine months ended September 30, 2011 and 2010, respectively.

### ***Interest Expense***

Interest expense for the nine months ended September 30, 2011 totaled \$26.1 million, an increase of \$0.6 million compared to the nine months ended September 30, 2010. This increase reflects interest on increased debt levels during the current year, partially offset by prior year costs of \$1.1 million that relate to the partial settlement of an interest rate swap. Excluding the effects of fair value adjustments to this swap in 2010, our aggregate effective interest rate was 6.7% for the nine months ended September 30, 2011 compared to 6.8% for 2010.

### ***State Income Tax***

We recorded state income taxes of \$169,000 and \$216,000 for the nine months ended September 30, 2011 and 2010, respectively, which are solely attributable to the Texas margin tax.

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**LIQUIDITY AND CAPITAL RESOURCES**

***Overview***

During the nine months ended September 30, 2011, we received advances totaling \$93 million and repaid \$50 million, resulting in net borrowings of \$43 million under our \$275 million senior secured revolving credit facility (the "Credit Agreement"). There was an outstanding balance of \$202 million at September 30, 2011.

The Credit Agreement is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It also is available to fund letters of credit up to a \$50 million sub-limit and to fund distributions to unitholders up to a \$30 million sub-limit.

In March 2010, we issued \$150 million in aggregate principal amount of 8.25% senior notes maturing March 15, 2018 (the "8.25% Senior Notes"). A portion of the \$147.5 million in net proceeds received was used to fund our \$93 million purchase of the Tulsa and Lovington storage assets from HFC on March 31, 2010. Additionally, we used a portion to repay \$42 million in outstanding Credit Agreement borrowings, with the remaining proceeds available for general partnership purposes, including working capital and capital expenditures. In addition, we have outstanding \$185 million in aggregate principal amount of 6.25% senior notes maturing March 1, 2015 (the "6.25% Senior Notes") that are registered with the SEC.

Under our registration statement filed with the SEC using a "shelf" registration process, we currently have the ability to raise \$860 million through security offerings, through one or more prospectus supplements that would describe, among other things, the specific amounts, prices and terms of any securities offered and how the proceeds would be used. Any proceeds from the sale of securities would be used for general business purposes, which may include, among other things, funding acquisitions of assets or businesses, working capital, capital expenditures, investments in subsidiaries, the retirement of existing debt and/or the repurchase of common units or other securities.

We believe our current cash balances, future internally generated funds and funds available under the Credit Agreement will provide sufficient resources to meet our working capital liquidity needs for the foreseeable future.

In February, May and August 2011 we paid regular quarterly cash distributions of \$0.845, \$0.855 and \$0.865, respectively, on all units in an aggregate amount of \$68 million. Included in these distributions were \$10 million of incentive distribution payments to the general partner.

Cash and cash equivalents increased by \$1.4 million during the nine months ended September 30, 2011. The cash flows provided by operating activities of \$62.6 million exceeded the combined cash flows used for investing and financing activities of \$31.5 million and \$29.8 million, respectively. Working capital increased by \$15.3 million to \$7.6 million at September 30, 2011 from a deficit of \$7.7 million at December 31, 2010.

***Cash Flows - Operating Activities***

Cash flows from operating activities decreased by \$3.5 million from \$66.1 million for the nine months ended September 30, 2010 to \$62.6 million for the nine months ended September 30, 2011. This decrease is due principally to payments attributable to increased interest and operating expenses, net of \$4.7 million in additional cash collections from our customers.

Our major shippers are obligated to make deficiency payments to us if they do not meet their minimum volume shipping obligations. Under certain agreements with these shippers, they have the right to recapture these amounts if future volumes exceed minimum levels. We billed \$9 million during the nine months ended September 30, 2010 related to shortfalls that subsequently expired without recapture and were recognized as revenue during the nine months ended September 30, 2011. We recognized an additional \$0.9 million related to shortfalls billed in the fourth quarter of 2010 as a result of an amendment to the Alon PTA in June 2011 that limits the carryover term of credits attributable to such shortfall billings to the calendar year end in which the shortfalls occurred. Another \$2 million is included in our accounts receivable at September 30, 2011 related to shortfalls that occurred during the third quarter of 2011.

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### ***Cash Flows Investing Activities***

Cash flows used for investing activities decreased by \$12.1 million from \$43.6 million for the nine months ended September 30, 2010 to \$31.5 million for the nine months ended September 30, 2011. During the nine months ended September 30, 2011 and 2010, we invested \$31.5 million and \$8.1 million in additions to properties and equipment, respectively. Additionally in March 2010, we acquired storage assets from HFC for \$36 million.

### ***Cash Flows Financing Activities***

Cash flows used for financing activities were \$29.8 million compared to \$24.4 million for the nine months ended September 30, 2010, an increase of \$5.4 million. During the nine months ended September 30, 2011, we received \$93 million and repaid \$50 million in advances under the Credit Agreement, paid \$68 million in regular quarterly cash distributions to our general and limited partners, paid \$3.2 million in financing costs to amend our previous credit agreement and paid \$1.6 million for the purchase of common units for recipients of our incentive grants. During the nine months ended September 30, 2010, we received \$52 million and repaid \$101 million in advances under the Credit Agreement. Additionally, we received \$147.5 million in net proceeds and incurred \$0.5 million in financing costs upon the issuance of the 8.25% Senior Notes. For the nine months ended September 30, 2010, we paid \$62.6 million in regular quarterly cash distributions to our general and limited partners, paid \$57.5 million in excess of HFC's transferred basis in the storage assets acquired in March 2010 and paid \$2.3 million for the purchase of common units for recipients of our incentive grants.

### ***Capital Requirements***

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

Each year the board of directors of Holly Logistic Services, L.L.C., the general partner of our general partner (HLS), approves our annual capital budget, which specifies capital projects that our management is authorized to undertake. Additionally, at times when conditions warrant or as new opportunities arise, special projects may be approved. The funds allocated for a particular capital project may be expended over a period in excess of a year, depending on the time required to complete the project. Therefore, our planned capital expenditures for a given year consist of expenditures approved for capital projects included in the current year's capital budget as well as, in certain cases, expenditures approved for capital projects in capital budgets for prior years. The 2011 capital budget is comprised of \$5.8 million for maintenance capital expenditures and \$20.1 million for expansion capital expenditures.

In August 2011, we completed construction of five interconnecting pipelines between HFC's Tulsa east and west refining facilities, costing approximately \$35 million. These pipelines were placed in service in September 2011.

We have announced an agreement in principle with HFC, subject to the execution of definitive agreements and certain closing conditions, for the acquisition of certain pipeline, tankage, loading rack and crude receiving assets located at HFC's El Dorado and Cheyenne refineries for \$340 million. The purchase price is expected to be paid in promissory notes with an aggregate original principal amount of \$150 million and we will issue HFC an additional number of our common units having a value equal to the remaining \$190 million purchase price.

Additionally, we have two expansion projects to provide 60,000 bpd of additional crude pipeline take-away capacity resulting from increased Delaware Basin drilling activity in southeast New Mexico. The first project will increase one of our existing crude oil trunk lines from 35,000 bpd to 60,000 bpd. This project



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which includes the replacement of 5 miles of existing pipe with larger diameter pipe is expected to cost approximately \$2 million with completion in the first half of 2012. The second project will consist of the reactivation and conversion to crude oil service a 70-mile, 8-inch petroleum products pipeline owned by us. Once in service, this pipeline would be capable of transporting up to 35,000 bpd of crude oil from the Carlsbad, New Mexico area to either a common carrier pipeline station for transport to major crude oil markets or to HFC's New Mexico refining facilities. The scope of this second project has not yet been finalized. Subject to receipt of acceptable shipper support and board approval, this project could also be completed during the first half of 2012.

We have an option agreement with HFC, granting us an option to purchase HFC's 75% equity interest in UNEV Pipeline, LLC ( "UNEV Pipeline" ), a joint venture pipeline currently under construction that will be capable of transporting refined petroleum products from Salt Lake City, Utah to Las Vegas, Nevada. Under this agreement, we have an option to purchase HFC's equity interest in the UNEV Pipeline, effective for a 180-day period commencing when the UNEV Pipeline becomes operational, at a purchase price equal to HFC'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 current total construction cost of the pipeline project including terminals is expected to be approximately \$385 million. This includes the construction of ethanol blending and storage facilities at the Cedar City terminal. HFC's share of this estimated cost is \$289 million and is exclusive of the 7% per annum interest cost under our option to purchase HFC's 75% interest in the UNEV Pipeline. The pipeline is in the final construction phase and is expected to be mechanically complete in November 2011.

We expect that our currently planned sustaining and maintenance capital expenditures as well as expenditures for acquisitions and capital development projects such as our option to purchase HFC's interest in the UNEV Pipeline described above, will be funded with existing cash generated by operations, the sale of additional limited partner common units, the issuance of debt securities and advances under our Credit Agreement, or a combination thereof. With volatility and uncertainty at times in the credit and equity markets, there may be limits on our ability to issue new debt or equity financing. Additionally, due to pricing movements in the debt and equity markets, we may not be able to issue new debt and equity securities at acceptable pricing. Without additional capital beyond amounts available under the Credit Agreement, our ability to fund some of these capital projects may be limited, especially the UNEV Pipeline. We are not obligated to purchase the UNEV Pipeline nor are we subject to any fees or penalties if HLS' board of directors decides not to proceed with this opportunity.

### ***Credit Agreement***

We have a \$275 million Credit Agreement that is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is also available to fund letters of credit up to a \$50 million sub-limit and to fund distributions to unitholders up to a \$30 million sub-limit. In February 2011, we amended our previous credit agreement (expiring in August 2011), extending the expiration date and slightly reducing the size of the credit facility from \$300 million to \$275 million. The size was reduced based on management's review of past and forecasted utilization of the facility. The Credit Agreement expires in February 2016; however, in the event that the 6.25% Senior Notes are not repurchased, refinanced, extended or repaid prior to September 1, 2014, the Credit Agreement shall expire on that date.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P., our general partner, and guaranteed by our material, wholly-owned subsidiaries. Any recourse to HEP Logistics Holdings, L.P. would be limited to the extent of its assets, which other than its investment in us, are not significant.

We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs.

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 1.00% to 2.00%) or (b) at a rate equal to the London Interbank Offered Rate ( "LIBOR" ) plus an applicable margin (ranging from

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2.00% to 3.00%). In each case, the applicable margin is based upon the ratio of our funded debt (as defined in the Credit 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 an annual rate ranging from 0.375% to 0.50% based upon the ratio of our funded debt to EBITDA for the four most recently completed fiscal quarters.

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

**Senior Notes**

The 6.25% Senior Notes and 8.25% Senior Notes (collectively, the Senior Notes) are unsecured and impose certain restrictive covenants which we are subject to and currently in compliance with, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights under the Senior Notes.

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

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

|   | September 30,<br>2011 | December 31,<br>2010 |
|---|-----------------------|----------------------|
|   | (In thousands)        |                      |
| Credit Agreement                                  | \$ 202,000            | \$ 159,000           |
| 6.25% Senior Notes                                |                       |                      |
| Principal   | 185,000               | 185,000              |
| Unamortized discount                              | (1,299)               | (1,584)              |
| Unamortized premium dedesignated fair value hedge | 1,184                 | 1,444                |
|   | 184,885               | 184,860              |
| 8.25% Senior Notes                                |                       |                      |
| Principal   | 150,000               | 150,000              |
| Unamortized discount                              | (1,983)               | (2,212)              |
|   | 148,017               | 147,788              |
| Total long-term debt                              | \$ 534,902            | \$ 491,648           |

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

**Contractual Obligations**

During the nine months ended September 30, 2011, we had net borrowings of \$43 million resulting in \$202 million of borrowings outstanding under the Credit Agreement at September 30, 2011.

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



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### ***Impact of Inflation***

Inflation in the United States has been relatively moderate in recent years and did not have a material impact on our results of operations for the nine months ended September 30, 2011 and 2010. Historically, the PPI has increased an average of 3% annually over the past 5 calendar years. However, the September 30, 2011 PPI increased at a rate of 7% on a year-over-year basis.

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

### ***Environmental Matters***

Our operation of pipelines, terminals, and associated facilities in connection with the transportation and storage of refined products and crude oil is subject to stringent and complex federal, state, and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment. As with the industry generally, compliance with existing and anticipated laws and regulations increases our overall cost of business, including our capital costs to construct, maintain, and upgrade equipment and facilities. While these laws and regulations affect our maintenance capital expenditures and net income, we believe that they do not affect our competitive position 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.

Under the Omnibus Agreement, HFC agreed to indemnify us up to certain aggregate amounts for any environmental noncompliance and remediation liabilities associated with assets transferred to us and occurring or existing prior to the date of such transfers. The transfers that are covered by the agreement include the refined product pipelines, terminals and tanks transferred by HFC's subsidiaries in connection with our initial public offering in July 2004, the intermediate pipelines acquired in July 2005, the crude pipelines and tankage assets acquired in 2008, and the asphalt loading rack facility acquired in March 2010. The Omnibus Agreement provides environmental indemnification of up to \$15 million for the assets transferred to us, other than the crude pipelines and tankage assets, plus an additional \$2.5 million for the intermediate pipelines acquired in July 2005. Except as described below, HFC's indemnification obligations described above will remain in effect for an asset for ten years following the date it is transferred to us. The Omnibus Agreement also provides an additional \$7.5 million of indemnification through 2023 for environmental noncompliance and remediation liabilities specific to the crude pipelines and tankage assets. HFC's indemnification obligations described above do not apply to (i) the Tulsa west loading racks acquired in August 2009, (ii) the 16-inch intermediate pipeline acquired in June 2009, (iii) the Roadrunner Pipeline, (iv) the Beeson Pipeline, (v) the logistics and storage assets acquired from Sinclair in December 2009, or (vi) the Tulsa east storage tanks and loading racks acquired in March 2010.

Under provisions of the HFC ETA and HFC PTTA, HFC will indemnify us for environmental liabilities arising from our pre-ownership operations of the Tulsa west loading rack facilities acquired from HFC in August 2009, the Tulsa logistics and storage assets acquired from Sinclair in December 2009 and the Tulsa east storage tanks and loading racks acquired from HFC in March 2010. Additionally, HFC agreed to indemnify us for any liabilities arising from HFC's operation of the loading racks under the HFC ETA.

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We have an environmental agreement with Alon with respect to pre-closing environmental costs and liabilities relating to the pipelines and terminals acquired from Alon in 2005, under which Alon will indemnify us through 2015, subject to a \$100,000 deductible and a \$20 million maximum liability cap.

There are environmental remediation projects that are currently in progress that relate to certain assets acquired from HFC. Certain of these projects were underway prior to our purchase and represent liabilities of HFC as the obligation for future remediation activities was retained by HFC. At September 30, 2011, we have an accrual of \$0.2 million that relates to environmental clean-up projects for which we have assumed liability. The remaining projects, including assessment and monitoring activities, are covered under the HFC environmental indemnification discussed above and represent liabilities of HFC.

## **CRITICAL ACCOUNTING POLICIES**

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities as of the date of the financial statements. Actual results may differ from these estimates. 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, 2010. 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 2011. We consider these policies to be the most critical to understanding the judgments that are involved and the uncertainties that could impact our results of operations, financial condition and cash flows.

### ***New Accounting Pronouncements***

#### ***Presentation of Comprehensive Income***

In June 2011, an accounting standard update was issued that requires the presentation of net income and other comprehensive income in one continuous statement or in two separate, but consecutive, statements and eliminates the option to present the components of other comprehensive income in the statement of partners' equity. This accounting standard update is effective January 1, 2012 and will be applied retrospectively. This update will not have an impact on our financial condition, results of operations and cash flows.

#### ***Intangibles Goodwill and Other: Testing Goodwill for Impairment***

In September 2011, an accounting standard update was issued that allows entities an option to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. Under this option, an entity is no longer required to calculate the fair value of a reporting unit unless the entity determines, based on that qualitative assessment, that it is more likely than not that the reporting unit's fair value is less than its carrying amount. This accounting standard update is effective for annual and interim goodwill impairment tests performed beginning January 1, 2012. This update will not have an impact on our financial condition, results of operations and cash flows.

## **RISK MANAGEMENT**

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

As of September 30, 2011, we have an interest rate swap that hedges our exposure to the cash flow risk caused by the effects of LIBOR changes on a \$155 million Credit Agreement advance. This interest rate swap effectively converts \$155 million of LIBOR based debt to fixed rate debt having an interest rate of 3.74% plus an applicable margin currently 2.5%, which equals an effective interest rate of 6.24% as of September 30, 2011. This swap contract matures in February 2013.



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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 \$155 million of our 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 the offsetting fair value adjustment to accumulated other comprehensive loss. Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swap against the expected future interest payments on \$155 million of our variable rate debt. Any ineffectiveness is reclassified from accumulated other comprehensive loss to interest expense. To date, we have had no ineffectiveness on our cash flow hedge.

At September 30, 2011, we have an accumulated other comprehensive loss of \$7.4 million that relates to our cash flow hedge. Of this amount, approximately \$5 million will be effectively transferred from accumulated other comprehensive loss into interest expense as interest is paid on the underlying swap agreement over the next twelve-month period, assuming interest rates remain unchanged.

Additional information on our interest rate swap is as follows:

| Derivative Instrument  | Balance Sheet Location      | Fair Value<br>(In thousands) | Location of Offsetting Balance       | Offsetting Amount |
|--|-----------------------------|------------------------------|--------------------------------------|-------------------|
| <b>September 30, 2011</b>  |                             |                              |                                      |                   |
| <i>Interest rate swap designated as cash flow hedging instrument:</i>                      |                             |                              |                                      |                   |
| Variable-to-fixed interest rate swap contract (\$155 million of LIBOR based debt interest) | Other long-term liabilities | \$ 7,378                     | Accumulated other comprehensive loss | \$ 7,378          |
| <b>December 31, 2010</b>   |                             |                              |                                      |                   |
| <i>Interest rate swap designated as cash flow hedging instrument:</i>                      |                             |                              |                                      |                   |
| Variable-to-fixed interest rate swap contract (\$155 million of LIBOR based debt interest) | Other long-term liabilities | \$ 10,026                    | Accumulated other comprehensive loss | \$ 10,026         |

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

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

At September 30, 2011, we had an outstanding principal balance on our 6.25% Senior Notes and 8.25% Senior Notes of \$185 million and \$150 million, respectively. A change in interest rates would generally affect the fair value of the Senior Notes, but not our earnings or cash flows. At September 30, 2011, the fair value of our 6.25% Senior Notes and 8.25% Senior Notes were \$182.7 million and \$155.3 million, respectively. We estimate a hypothetical 10% change in the yield-to-maturity applicable to the 6.25% Senior Notes and 8.25% Senior Notes at September 30, 2011 would result in a change of approximately \$4.3 million and \$6.3 million, respectively, in the fair value of the underlying notes.

For the variable rate Credit Agreement, changes in interest rates would affect cash flows, but not the fair value. At September 30, 2011, borrowings outstanding under the Credit Agreement were \$202 million. By means of our cash flow hedge, we have effectively converted the variable rate on \$155 million of outstanding borrowings to a fixed rate of 6.24%. For the remaining unhedged Credit Agreement borrowings of \$47 million, a hypothetical 10% change in interest rates applicable to the Credit Agreement would not materially affect our cash flows.

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At September 30, 2011, our cash and cash equivalents included highly liquid investments with a maturity of three months or less at the time of purchase. Due to the short-term nature of our cash and cash equivalents, a hypothetical 10% increase in interest rates would not have a material effect on the fair market value of our portfolio. Since we have the ability to liquidate this portfolio, we do not expect our operating results or cash flows to be materially affected by the effect of a sudden change in market interest rates on our investment portfolio.

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

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



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### **Item 3. Quantitative and Qualitative Disclosures About Market 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 Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this quarterly report on Form 10-Q. Our disclosure controls and procedures are designed to provide reasonable assurance that the information we are required to disclose in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure and is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Based upon the evaluation, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were effective as of September 30, 2011.

#### **(b) Changes in internal control over financial reporting**

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

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PART II. OTHER INFORMATION

**Item 1. Legal Proceedings**

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

**Item 6. Exhibits**

The Exhibit Index on page 45 of this Quarterly Report on Form 10-Q lists the exhibits that are filed or furnished, as applicable, as part of the Quarterly Report on Form 10-Q.

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HOLLY ENERGY PARTNERS, L.P.

**SIGNATURES**

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

HOLLY ENERGY PARTNERS, L.P.  
(Registrant)

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

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

Date: October 28, 2011

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

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

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**Exhibit Index**

| Exhibit Number | Description  |
|----------------|--|
| 10.1           | Second Amended and Restated Pipelines, Tankage, and Loading Rack Throughput Agreement, dated August 31, 2011 (incorporated by reference to Exhibit 10.1 of Registrant's Form 8-K Current Report dated September 1, 2011, File No. 1-32225).  |
| 10.2           | Fifth Amended and Restated Omnibus Agreement, dated August 31, 2011 (incorporated by reference to Exhibit 10.2 of Registrant's Form 8-K Current Report dated September 1, 2011, File No. 1-32225).   |
| 10.3+          | Letter Agreement, dated October 14, 2011, regarding the Amended and Restated Crude Pipelines and Tankage Agreement, dated December 1, 2009.  |
| 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.  |
| 101**          | The following financial information from Holly Energy Partners, L.P.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2011, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, (iv) Consolidated Statements of Partners Equity, and (v) Notes to Consolidated Financial Statements (tagged as blocks of text). |

+ Filed herewith.

++ Furnished herewith.

\*\* Furnished electronically herewith.