HollyFrontier Corp
Form 10-Q
May 04, 2016

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

FORM 10-Q

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

For the quarterly period ended March 31, 2016
OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to _____________
Commission File Number 1-3876

HOLLYFRONTIER CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	75-1056913
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2828 N. Harwood, Suite 1300 Dallas, Texas	75201
(Address of principal executive offices)	(Zip Code)

(214) 871-3555
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
176,519,301 shares of Common Stock, par value $.01 per share, were outstanding on April 29, 2016.

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FORWARD-LOOKING STATEMENTS

References herein to HollyFrontier Corporation ("HollyFrontier") include HollyFrontier and its consolidated subsidiaries. In accordance with the Securities and Exchange Commission's ("SEC") "Plain English" guidelines, this Quarterly Report on Form 10-Q has been written in the first person. In this document, the words "we," "our," "ours" and "us" refer only to HollyFrontier and its consolidated subsidiaries or to HollyFrontier or an individual subsidiary and not to any other person with certain exceptions. Generally, the words "we," "our," "ours" and "us" include Holly Energy Partners, L.P. ("HEP") and its subsidiaries as consolidated subsidiaries of HollyFrontier, unless when used in disclosures of transactions or obligations between HEP and HollyFrontier or its other subsidiaries. This document contains certain disclosures of agreements that are specific to HEP and its consolidated subsidiaries and do not necessarily represent obligations of HollyFrontier. When used in descriptions of agreements and transactions, "HEP" refers to HEP and its consolidated subsidiaries.

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," "Liquidity and Capital Resources" and "Risk Management" in Part I, Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations" and those in Part II, Item 1 "Legal Proceedings" are forward-looking statements. Forward-looking statements use words such as "anticipate," "project," "expect," "plan," "goal," "forecast," "intend," "should," "would," "could," "believe," "may," and similar expressions and state regarding our plans and objectives for future operations. 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. All statements concerning our expectations for future results of operations are based on forecasts for our existing operations and do not include the potential impact of any future acquisitions. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot assure you that our expectations will prove to be correct. Therefore, actual outcomes and results could materially differ 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 actions of actual or potential competitive suppliers of refined petroleum products in our markets;
- the demand for and supply of crude oil and refined products;
- the spread between market prices for refined products and market prices for crude oil;
- the possibility of constraints on the transportation of refined products;
- the possibility of inefficiencies, curtailments or shutdowns in refinery operations or pipelines;
- effects of governmental and environmental regulations and policies;
- the availability and cost of our financing;
- the effectiveness of our capital investments and marketing strategies;
- our efficiency in carrying out construction projects;
- our ability to acquire refined product operations or pipeline and terminal operations on acceptable terms and to integrate any existing or future acquired operations;
- the possibility of terrorist attacks and the consequences of any such attacks;
- general economic conditions; and
- other financial, operational and legal risks and uncertainties detailed from time to time in our SEC filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, the forward-looking statements that are referred to above. This summary discussion should be read in conjunction with the discussion of the known material risk factors and other cautionary statements under the heading "Risk Factors" included in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015 and in conjunction with the discussion in this Form 10-Q in "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the heading "Liquidity and Capital Resources." All forward-looking statements included in this Form 10-Q and all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements speak only as of the date made and, other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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PART I. FINANCIAL INFORMATION

DEFINITIONS

Within this report, the following terms have these specific meanings:

“BPD” means the number of barrels per calendar day of crude oil or petroleum products.

“BPSD” means the number of barrels per stream day (barrels of capacity in a 24 hour period) of crude oil or petroleum products.

“Biodiesel” means a clean alternative fuel produced from renewable biological resources.

“Black wax crude oil” is a low sulfur, low gravity crude oil produced in the Uintah Basin in Eastern Utah that has certain characteristics that require specific facilities to transport, store and refine into transportation fuels.

“Cracking” means the process of breaking down larger, heavier and more complex hydrocarbon molecules into simpler and lighter molecules.

“Crude oil distillation” means the process of distilling vapor from liquid crudes, usually by heating, and condensing the vapor slightly above atmospheric pressure turning it back to liquid in order to purify, fractionate or form the desired products.

“Ethanol” means a high octane gasoline blend stock that is used to make various grades of gasoline.

“FCC,” or fluid catalytic cracking, means a refinery process that breaks down large complex hydrocarbon molecules into smaller more useful ones using a circulating bed of catalyst at relatively high temperatures.

“Hydrodesulfurization” means to remove sulfur and nitrogen compounds from oil or gas in the presence of hydrogen and a catalyst at relatively high temperatures.

“Hydrogen plant” means a refinery unit that converts natural gas and steam to high purity hydrogen, which is then used in the hydrodesulfurization, hydrocracking and isomerization processes.

“Isomerization” means a refinery process for rearranging the structure of C5/C6 molecules without changing their size or chemical composition and is used to improve the octane of C5/C6 gasoline blendstocks.

“LPG” means liquid petroleum gases.

“Lubricant” or “lube” means a solvent neutral paraffinic product used in commercial heavy duty engine oils, passenger car oils and specialty products for industrial applications such as heat transfer, metalworking, rubber and other general process oil.

“MSAT2” means Control of Hazardous Air Pollutants from Mobile Sources, a rule issued by the U.S. Environmental Protection Agency to reduce hazardous emissions from motor vehicles and motor vehicle fuels.

“MMBTU” means one million British thermal units.

“Refinery gross margin” means the difference between average net sales price and average product costs per produced barrel of refined products sold. This does not include the associated depreciation and amortization costs.

“Sour crude oil” means crude oil containing quantities of sulfur greater than 0.4 percent by weight, while “sweet crude oil” means crude oil containing quantities of sulfur equal to or less than 0.4 percent by weight.

“Vacuum distillation” means the process of distilling vapor from liquid crudes, usually by heating, and condensing the vapor below atmospheric pressure turning it back to a liquid in order to purify, fractionate or form the desired products.

“WTI” means West Texas Intermediate and is a grade of crude oil used as a common benchmark in oil pricing. WTI is a sweet crude oil and has a relatively low density.

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Item 1. Financial Statements
HOLLYFRONTIER CORPORATION
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	March 31, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents (HEP: $9,034 and $15,013, respectively)	$111,021	$66,533
Marketable securities	—	144,019
Total cash, cash equivalents and short-term marketable securities	111,021	210,552
Accounts receivable: Product and transportation (HEP: $41,055 and $41,075, respectively)	410,764	323,858
Crude oil resales	20,150	28,120
	430,914	351,978
Inventories: Crude oil and refined products	762,800	712,865
Materials, supplies and other (HEP: $2,122 and $1,972, respectively)	129,138	129,004
	891,938	841,869
Income taxes receivable	32,813	—
Prepayments and other (HEP: $3,059 and $3,082, respectively)	32,584	43,666
Total current assets	1,499,270	1,448,065
Properties, plants and equipment, at cost (HEP: $1,383,186 and $1,397,965, respectively)	5,625,455	5,490,189
Less accumulated depreciation (HEP: $(290,743) and $(298,282), respectively)	(1,429,198)	(1,374,527)
	4,196,257	4,115,662
Other assets: Turnaround costs	263,773	231,873
Goodwill (HEP: $288,991 and $288,991, respectively)	2,331,781	2,331,781
Intangibles and other (HEP: $170,896 and $128,583, respectively)	303,206	260,918
	2,898,760	2,824,572
Total assets	$8,594,287	$8,388,299
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable (HEP: $18,480 and $22,583, respectively)	$731,271	$716,490
Income taxes payable	—	8,142
Accrued liabilities (HEP: $16,074 and $26,341, respectively)	154,337	135,983
Total current liabilities	885,608	860,615
Long-term debt (HEP: $1,061,944 and $1,008,752, respectively)	1,308,168	1,040,040
Deferred income taxes (HEP: $458 and $431, respectively)	544,308	497,906
Other long-term liabilities (HEP: $55,381 and $59,376, respectively)	213,005	179,965
Equity:		
HollyFrontier stockholders' equity:		
Preferred stock, $1.00 par value – 5,000,000 shares authorized; none issued	—	—
Common stock $.01 par value – 320,000,000 shares authorized; 255,962,866 shares issued as of March 31, 2016 and December 31, 2015	2,560	2,560
Additional capital	4,011,634	4,011,052

Retained earnings	3,234,040	3,271,189
Accumulated other comprehensive loss	(4,566)	(4,155)
Common stock held in treasury, at cost – 79,442,190 and 75,728,478 shares as of March 31, 2016 and December 31, 2015, respectively	(2,156,844)	(2,027,231)
Total HollyFrontier stockholders' equity	5,086,824	5,253,415
Noncontrolling interest	556,374	556,358
Total equity	5,643,198	5,809,773
Total liabilities and equity	$8,594,287	$8,388,299

Parenthetical amounts represent asset and liability balances attributable to Holly Energy Partners, L.P. ("HEP") as of March 31, 2016 and December 31, 2015. HEP is a consolidated variable interest entity.

See accompanying notes.

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HOLLYFRONTIER CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)
(In thousands, except per share data)

	Three Months Ended March 31, 2016	2015
Sales and other revenues	$2,018,724	$3,006,626
Operating costs and expenses:		
Cost of products sold (exclusive of depreciation and amortization):		
Cost of products sold (exclusive of lower of cost or market inventory valuation adjustment)	1,625,163	2,251,373
Lower of cost or market inventory valuation adjustment	(56,121)	(6,546)
	1,569,042	2,244,827
Operating expenses (exclusive of depreciation and amortization)	252,583	263,596
General and administrative expenses (exclusive of depreciation and amortization)	25,621	29,569
Depreciation and amortization	87,880	80,012
Total operating costs and expenses	1,935,126	2,618,004
Income from operations	83,598	388,622
Other income (expense):		
Earnings (loss) of equity method investments	2,765	(7,807)
Interest income	75	962
Interest expense	(12,087)	(10,154)
Loss on early extinguishment of debt	(8,718)	—
Gain on sale of assets and other	65	766
	(17,900)	(16,233)
Income before income taxes	65,698	372,389
Income tax provision:		
Current	(24,354)	139,198
Deferred	46,662	(9,470)
	22,308	129,728
Net income	43,390	242,661
Less net income attributable to noncontrolling interest	22,137	15,785
Net income attributable to HollyFrontier stockholders	$21,253	$226,876
Earnings per share attributable to HollyFrontier stockholders:		
Basic	$0.12	$1.16
Diluted	$0.12	$1.16
Cash dividends declared per common share	$0.33	$0.32
Average number of common shares outstanding:		
Basic	176,737	195,069
Diluted	176,784	195,121

See accompanying notes.

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HOLLYFRONTIER CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

	Three Months Ended March 31, 2016	2015
Net income	$ 43,390	$ 242,661
Other comprehensive income:		
Securities available-for-sale:		
Unrealized gain on marketable securities	78	108
Reclassification adjustments to net income on sale or maturity of marketable securities	23	(40)
Net unrealized gain on marketable securities	101	68
Hedging instruments:		
Change in fair value of cash flow hedging instruments	(12,604)	(15,428)
Reclassification adjustments to net income on settlement of cash flow hedging instruments	11,286	(4,161)
Amortization of unrealized loss attributable to discontinued cash flow hedges	270	270
Net unrealized loss on hedging instruments	(1,048)	(19,319)
Other comprehensive loss before income taxes	(947)	(19,251)
Income tax benefit	(261)	(7,275)
Other comprehensive loss	(686)	(11,976)
Total comprehensive income	42,704	230,685
Less noncontrolling interest in comprehensive income	21,862	15,331
Comprehensive income attributable to HollyFrontier stockholders	$ 20,842	$ 215,354

See accompanying notes.

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HOLLYFRONTIER CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

	Three Months Ended March 31,	
	2016	2015
Cash flows from operating activities:		
Net income	$43,390	$242,661
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	87,880	80,012
Lower of cost or market inventory valuation adjustment	(56,121)	(6,546)
Net (gain) loss of equity method investments, inclusive of distributions	(265)	8,557
Gain on sale of assets	(23)	(766)
Loss on early extinguishment of debt	8,718	—
Deferred income taxes	46,662	(9,470)
Equity-based compensation expense	3,226	7,225
Change in fair value – derivative instruments	3,189	2,223
(Increase) decrease in current assets:		
Accounts receivable	(78,936)	63,517
Inventories	7,276	(74,001)
Income taxes receivable	(32,813)	11,719
Prepayments and other	10,586	22,203
Increase (decrease) in current liabilities:		
Accounts payable	2,401	(165,839)
Income taxes payable	(10,555)	92,374
Accrued liabilities	8,519	(3,059)
Turnaround expenditures	(36,994)	(29,100)
Other, net	496	5,182
Net cash provided by operating activities	6,636	246,892
Cash flows from investing activities:		
Additions to properties, plants and equipment	(131,700)	(120,892)
Additions to properties, plants and equipment – HEP	(17,873)	(51,727)
Proceeds from sale of assets	258	814
Purchases of marketable securities	(4,082)	(118,816)
Sales and maturities of marketable securities	148,204	178,524
Net cash used for investing activities	(5,193)	(112,097)
Cash flows from financing activities:		
Borrowings under credit agreements	837,000	153,500
Repayments under credit agreements	(784,000)	(130,500)
Net proceeds from issuance of senior notes	246,690	—
Repayment of financing obligation	(39,500)	—
Inventory repurchase obligation	693	7,434
Purchase of treasury stock	(133,430)	(55,065)
Dividends	(58,602)	(62,335)
Distributions to noncontrolling interest	(21,731)	(20,472)
Other, net	(4,075)	(1,250)

Net cash provided by (used for) financing activities	43,045	(108,688)
Cash and cash equivalents:		
Increase for the period	44,488	26,107
Beginning of period	66,533	567,985
End of period	$111,021	$594,092
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$15,261	$14,522
Income taxes	$19,166	$38,985

See accompanying notes.

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HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1: Description of Business and Presentation of Financial Statements

References herein to HollyFrontier Corporation ("HollyFrontier") include HollyFrontier and its consolidated subsidiaries. In accordance with the Securities and Exchange Commission's ("SEC") "Plain English" guidelines, this Quarterly Report on Form 10-Q has been written in the first person. In these financial statements, the words "we," "our," "ours" and "us" refer only to HollyFrontier and its consolidated subsidiaries or to HollyFrontier or an individual subsidiary and not to any other person, with certain exceptions. Generally, the words "we," "our," "ours" and "us" include Holly Energy Partners, L.P. ("HEP") and its subsidiaries as consolidated subsidiaries of HollyFrontier, unless when used in disclosures of transactions or obligations between HEP and HollyFrontier or its other subsidiaries. These financial statements contain certain disclosures of agreements that are specific to HEP and its consolidated subsidiaries and do not necessarily represent obligations of HollyFrontier. When used in descriptions of agreements and transactions, "HEP" refers to HEP and its consolidated subsidiaries.

We are principally an independent petroleum refiner that produces high-value light products such as gasoline, diesel fuel, jet fuel, specialty lubricant products, and specialty and modified asphalt. We own and operate petroleum refineries that serve markets throughout the Mid-Continent, Southwest and Rocky Mountain regions of the United States. As of March 31, 2016, we:

- owned and operated a petroleum refinery in El Dorado, Kansas (the "El Dorado Refinery"), two refinery facilities located in Tulsa, Oklahoma (collectively, the "Tulsa Refineries"), a refinery in Artesia, New Mexico that is operated in conjunction with crude oil distillation and vacuum distillation and other facilities situated 65 miles away in Lovington, New Mexico (collectively, the "Navajo Refinery"), a refinery located in Cheyenne, Wyoming (the "Cheyenne Refinery") and a refinery in Woods Cross, Utah (the "Woods Cross Refinery");
- owned and operated HollyFrontier Asphalt Company LLC ("HFC Asphalt") which operates various asphalt terminals in Arizona, New Mexico and Oklahoma; and
- owned a 39% interest in HEP, a consolidated variable interest entity ("VIE"), which includes our 2% general partner interest.

We have prepared these consolidated financial statements without audit. In management's opinion, these consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of our consolidated financial position as of March 31, 2016, the consolidated results of operations and comprehensive income for the three months ended March 31, 2016 and 2015 and consolidated cash flows for the three months ended March 31, 2016 and 2015 in accordance with the rules and regulations of the SEC. Although certain notes and other information required by generally accepted accounting principles in the United States ("GAAP") have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2015 that has been filed with the SEC.

Our results of operations for the three months ended March 31, 2016 are not necessarily indicative of the results of operations to be realized for the year ending December 31, 2016.

Accounts Receivable: Our accounts receivable consist of amounts due from customers that are primarily companies in the petroleum industry. Credit is extended based on our evaluation of the customer's financial condition, and in certain circumstances collateral, such as letters of credit or guarantees, is required. We reserve for doubtful accounts based on our historical loss experience as well as specific accounts identified as high risk, which historically have been minimal. Credit losses are charged to the allowance for doubtful accounts when an account is deemed uncollectible. Our allowance for doubtful accounts was $2.3 million at both March 31, 2016 and December 31, 2015.

Inventories: Inventories are stated at the lower of cost, using the last-in, first-out (“LIFO”) method for crude oil, unfinished and finished refined products and the average cost method for materials and supplies, or market. In periods of rapidly declining prices, LIFO inventories may have to be written down to market value due to the higher costs assigned to LIFO layers in prior periods. In addition, the use of the LIFO inventory method may result in increases or decreases to cost of sales in years that inventory volumes decline as the result of charging cost of sales with LIFO inventory costs generated in prior periods. An actual valuation of inventory under the LIFO method is made at the end of each year based on the inventory levels at that time. Accordingly, interim LIFO calculations are based on management’s estimates of expected year-end inventory levels and are subject to the final year-end LIFO inventory valuation.

Goodwill: We have goodwill that primarily arose from our merger with Frontier Oil Corporation on July 1, 2011. Goodwill represents the excess of the cost of an acquired entity over the fair value of the assets acquired and liabilities assumed. Goodwill is not subject to amortization and is tested annually or more frequently if events or circumstances indicate the possibility of impairment. As of March 31, 2016, there have been no impairments to goodwill.

Historically, the refining industry has experienced significant fluctuations in operating results over an extended business cycle including changes in prices of crude oil and refined products, changes in operating costs including natural gas and higher costs of complying with government regulations. It is possible that the goodwill related to our Cheyenne Refinery will be determined to be impaired at some point in the future. A prolonged, moderate decrease in operating margins could potentially result in impairment to goodwill allocated to our Cheyenne reporting unit. Such impairment charges could be material.

Inventory Repurchase Obligations: We periodically enter into same-party sell / buy transactions, whereby we sell certain refined product inventory and subsequently repurchase the inventory in order to facilitate delivery to certain locations. Such sell / buy transactions are accounted as inventory repurchase obligations under which proceeds received under the initial sell is recognized as an inventory repurchase obligation that is subsequently reversed when the inventory is repurchased. For the three months ended March 31, 2016 and 2015, we received proceeds of $14.3 million and $30.2 million, respectively, and repaid $13.6 million and $22.8 million, respectively, under these sell / buy transactions.

New Accounting Pronouncements

Leases
In February 2016, Accounting Standard Update (“ASU”) 2016-02, “Leases” was issued requiring leases to be measured and recognized as a lease liability, with a corresponding right-of-use asset on the balance sheet. This standard has an effective date of January 1, 2019, and we are evaluating the impact of this standard.

Consolidation
In February 2015, ASU 2015-02, “Consolidation” was issued to improve consolidation guidance for certain legal entities. It modifies the evaluation of whether limited partnerships and similar legal entities are VIEs or voting interest entities, eliminates the presumption that a general partner should consolidate a limited partnership, affects the consolidation analysis of reporting entities involved with VIEs, particularly those that have fee arrangements and related party provisions and provides a scope exception from consolidation guidance for certain reporting entities that comply with or operate in accordance with requirements that are similar to those included in Rule 2a-7 of the

Investment Company Act of 1940 for registered money market funds. We adopted this standard effective January 1, 2016, which did not affect our financial position or results of operations.

Revenue Recognition
In May 2014, ASU 2014-09, “Revenue from Contracts with Customers” was issued requiring revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the expected consideration for these goods or services. This standard has an effective date of January 1, 2018, and we are evaluating the impact of this standard.

NOTE 2: Holly Energy Partners

HEP, a consolidated VIE, is a publicly held master limited partnership that owns and operates logistic assets consisting of petroleum product and crude oil pipelines, terminals, tankage, loading rack facilities and refinery processing units that principally support our refining and marketing operations in the Mid-Continent, Southwest and Rocky Mountain regions of the United States and Alon USA, Inc.'s ("Alon") refinery in Big Spring, Texas. Additionally, HEP owns a 75% interest in UNEV Pipeline, LLC ("UNEV"), the owner of a pipeline running from Woods Cross, Utah to Las Vegas, Nevada (the "UNEV Pipeline") and associated product terminals; a 50% interest in Frontier Pipeline Company, the owner of a pipeline running from Wyoming to Frontier Station, Utah (the "Frontier Pipeline"); a 50% interest in Osage Pipe Line Company, LLC, the owner of a pipeline running from Cushing, Oklahoma to El Dorado, Kansas (the "Osage Pipeline"); and a 25% interest in SLC Pipeline LLC, the owner of a pipeline (the "SLC Pipeline") that serves refineries in the Salt Lake City, Utah area.

As of March 31, 2016, we owned a 39% interest in HEP, including the 2% general partner interest. As the general partner of HEP, we have the sole ability to direct the activities that most significantly impact HEP's financial performance, and therefore we consolidate HEP.

HEP has two primary customers (including us) and generates revenues by charging tariffs for transporting petroleum products and crude oil through its pipelines, by charging fees for terminalling refined products and other hydrocarbons, and storing and providing other services at its storage tanks and terminals. Under our long-term transportation agreements with HEP (discussed further below), we accounted for 81% of HEP's total revenues for the three months ended March 31, 2016. We do not provide financial or equity support through any liquidity arrangements and / or debt guarantees to HEP.

HEP has outstanding debt under a senior secured revolving credit agreement and its senior notes. With the exception of the assets of HEP Logistics Holdings, L.P., one of our wholly-owned subsidiaries and HEP's general partner, HEP's creditors have no recourse to our other assets. Any recourse to HEP's general partner would be limited to the extent of HEP Logistics Holdings, L.P.'s assets, which other than its investment in HEP are not significant. Furthermore, our creditors have no recourse to the assets of HEP and its consolidated subsidiaries. See Note 9 for a description of HEP's debt obligations.

HEP has risk associated with its operations. If a major customer of HEP were to terminate its contracts or fail to meet desired shipping or throughput levels for an extended period of time, revenue would be reduced and HEP could suffer substantial losses to the extent that a new customer is not found. In the event that HEP incurs a loss, our operating results will reflect HEP's loss, net of intercompany eliminations, to the extent of our ownership interest in HEP at that point in time.

Tulsa Tanks
On March 31, 2016, HEP acquired crude oil tanks located at our Tulsa Refineries from an affiliate of Plains All American Pipeline, L.P. ("Plains") for $39.5 million. Previously in 2009, we sold these tanks to Plains and leased them back, and due to our continuing interest in the tanks, we accounted for the transaction as a financing arrangement. Accordingly, the tanks remained on our balance sheet and were depreciated for accounting purposes, and the proceeds received from Plains were recorded as a financing obligation and presented as a component of outstanding debt.

In accounting for HEP’s March 2016 purchase from Plains, the amount paid was recorded against our outstanding financing obligation balance of $30.8 million, with the excess $8.7 million payment resulting in a loss on early extinguishment of debt.

Magellan Asset Exchange

On February 22, 2016, we acquired a 50% membership interest in Osage Pipe Line Company, LLC (“Osage”) in exchange for a 20-year terminalling services agreement, whereby a subsidiary of Magellan Midstream Partners (“Magellan Midstream”) will provide terminalling services for all of our products originating in Artesia, New Mexico that require terminalling in or through El Paso, Texas. Under the agreement, we will be charged tariffs based on the volumes of refined product processed. Osage is the owner of the Osage Pipeline, a 135-mile pipeline that transports crude oil from Cushing, Oklahoma to our El Dorado Refinery in Kansas and also has a connection to the Jayhawk pipeline that services the CHS refinery in McPherson, Kansas. This exchange was accounted for at fair value, whereby the 50% membership interest in the Osage Pipeline was recorded at appraised fair value and an offsetting residual deferred credit in the amount of $38.9 million was recorded, which will be amortized over the 20-year service period. No gain or loss was recorded for this exchange.

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HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

Also on February 22, 2016, we contributed the 50% membership interest in Osage to HEP, and in exchange received HEP's El Paso terminal. Pursuant to this exchange, HEP agreed to build two connections to Magellan Midstream's El Paso terminal. In addition, HEP agreed to become operator of the Osage Pipeline. This exchange was accounted for at carry-over basis with no resulting gain or loss.

Transportation Agreements
HEP serves our refineries under long-term pipeline, terminal and tankage throughput agreements and refinery processing tolling agreements expiring from 2019 through 2030. Under these agreements, we pay HEP fees to transport, store and process throughput volumes of refined products, crude oil and feedstocks on HEP's pipeline, terminals, tankage, loading rack facilities and refinery processing units that result in minimum annual payments to HEP including UNEV (a consolidated subsidiary of HEP). Under these agreements, the agreed upon tariff rates are subject to annual tariff rate adjustments on July 1 at a rate based upon the percentage change in Producer Price Index or Federal Energy Regulatory Commission index. As of March 31, 2016, these agreements result in minimum annualized payments to HEP of $263.7 million.

Our transactions with HEP including the acquisitions discussed above and fees paid under our transportation agreements with HEP and UNEV are eliminated and have no impact on our consolidated financial statements.

NOTE 3: Fair Value Measurements

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt and derivative instruments. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value. HEP's outstanding credit agreement borrowings also approximate fair value as interest rates are reset frequently at current interest rates.

Fair value measurements are derived using inputs (assumptions that market participants would use in pricing an asset or liability, including assumptions about risk). GAAP categorizes inputs used in fair value measurements into three broad levels as follows:

- (Level 1) Quoted prices in active markets for identical assets or liabilities.
- (Level 2) Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.
- (Level 3) Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes valuation techniques that involve significant unobservable inputs.

The carrying amounts and estimated fair values of marketable securities, derivative instruments and senior notes at March 31, 2016 and December 31, 2015 were as follows:

	Carrying Amount	Fair Value	Fair Value by Input Level Level 1	Level 2	Level 3
	(In thousands)				
March 31, 2016					
Assets:					
Commodity price swaps	$33,619	$33,619	$—	$33,619	$ —
Forward contracts	4,197	4,197	—	4,197	—
Total assets	$37,816	$37,816	$—	$37,816	$ —
Liabilities:					
NYMEX futures contracts	$768	$768	$768	$—	$ —
Commodity price swaps	91,295	91,295	—	91,295	—
Forward contracts	6,947	6,947	—	6,947	—
HollyFrontier senior notes	246,224	250,313	—	250,313	—
HEP senior notes	296,944	295,500	—	295,500	—
HEP interest rate swaps	263	263	—	263	—
Total liabilities	$642,441	$645,086	$768	$644,318	$ —
December 31, 2015					
Assets:					
Marketable securities	$144,019	$144,019	$—	$144,019	$—
NYMEX futures contracts	3,469	3,469	3,469	—	—
Commodity price swaps	37,097	37,097	—	37,097	—
HEP interest rate swaps	304	304	—	304	—
Total assets	$184,889	$184,889	$3,469	$181,420	$—
Liabilities:					
Commodity price swaps	$98,930	$98,930	$—	$98,930	$—
HEP senior notes	296,752	295,500	—	295,500	—
HEP interest rate swaps	114	114	—	114	—
Total liabilities	$395,796	$394,544	$—	$394,544	$—

Level 1 Instruments
Our NYMEX futures contracts are exchange traded and are measured and recorded at fair value using quoted market prices, a Level 1 input.

Level 2 Instruments
Derivative instruments consisting of commodity price swaps, forward sales and purchase contracts and HEP's interest rate swaps are measured and recorded at fair value using Level 2 inputs. The fair values of the commodity price and interest rate swap contracts are based on the net present value of expected future cash flows related to both variable and fixed rate legs of the respective swap agreements. The measurements are computed using market-based

observable inputs, quoted forward commodity prices with respect to our commodity price swaps and the forward London Interbank Offered Rate (“LIBOR”) yield curve with respect to HEP’s interest rate swaps. The fair value of the senior notes is based on values provided by a third-party, which were derived using market quotes for similar type instruments, a Level 2 input.

Level 3 Instruments

We at times have forward commodity sales and purchase contracts for which quoted forward market prices are not readily available. The forward rate used to value these forward sales and purchase contracts are derived using a projected forward rate using quoted market rates for similar products, adjusted for regional pricing and grade differentials, a Level 3 input.

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The following table presents the changes in fair value of our Level 3 assets and liabilities (all related to derivative instruments) for the three months ended March 31, 2015:

Level 3 Instruments	Three Months Ended March 31, 2015 (In thousands)
Liability balance at beginning of period	$ —
Change in fair value:	
Recognized in other comprehensive income	(2,552)
Settlement date fair value of contractual maturities:	
Recognized in sales and other revenues	—
Liability balance at end of period	$ (2,552)

Additionally during the three months ended March 31, 2016, we recognized a non-recurring fair value measurement of $44.4 million that relates to HEP’s equity interest in Osage. The fair value was based on a combination of valuation methods including discounted cash flows, and the guideline public company and guideline transaction methods, level 3 inputs.

NOTE 4: Earnings Per Share

Basic earnings per share is calculated as net income attributable to HollyFrontier stockholders divided by the average number of shares of common stock outstanding. Diluted earnings per share assumes, when dilutive, the issuance of the net incremental shares from restricted shares and performance share units. The following is a reconciliation of the denominators of the basic and diluted per share computations for net income attributable to HollyFrontier stockholders:

	Three Months Ended March 31,	
	2016	2015
	(In thousands, except per share data)	
Net income attributable to HollyFrontier stockholders	$21,253	$226,876
Participating securities’ share in earnings	216	644
Net income attributable to common shares	$21,037	$226,232
Average number of shares of common stock outstanding	176,737	195,069
Effect of dilutive variable restricted shares and performance share units (1)	47	52
Average number of shares of common stock outstanding assuming dilution	176,784	195,121
Basic earnings per share	$0.12	$1.16

Diluted earnings per share	$0.12	$1.16
(1) Excludes anti-dilutive restricted and performance share units of:	177	