HollyFrontier Corp
Form 10-Q
November 05, 2015

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 September 30, 2015
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 (State or other jurisdiction of incorporation or organization)	75-1056913 (I.R.S. Employer Identification No.)
2828 N. Harwood, Suite 1300 Dallas, Texas (Address of principal executive offices)	75201 (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

182,905,387 shares of Common Stock, par value $.01 per share, were outstanding on October 30, 2015.

Table of Content

HOLLYFRONTIER CORPORATION
INDEX

Table of Content

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, 2014 and our Quarterly Report on Form 10-Q for the quarter ended June 30, 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.

Table of Content

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.

“WCS” means Western Canada Select crude oil and is made up of Canadian heavy conventional and bitumen crude oils blended with sweet synthetic and condensate diluents.

“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.

“WTS” means West Texas Sour, a medium sour crude oil.

Table of Content

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

	September 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents (HEP: $10,856 and $2,830, respectively)	$239,731	$567,985
Marketable securities	387,053	474,110
Total cash, cash equivalents and short-term marketable securities	626,784	1,042,095
Accounts receivable: Product and transportation (HEP: $32,968 and $40,129, respectively)	495,231	507,040
Crude oil resales	27,118	82,865
	522,349	589,905
Inventories: Crude oil and refined products	899,513	920,104
Materials, supplies and other (HEP: $1,903 and $1,940, respectively)	137,511	115,027
	1,037,024	1,035,131
Income taxes receivable	—	11,719
Deferred income tax assets	48,419	—
Prepayments and other (HEP: $2,671 and $2,443, respectively)	73,097	104,148
Total current assets	2,307,673	2,782,998
Properties, plants and equipment, at cost (HEP: $1,316,492 and $1,269,161, respectively)	5,309,079	4,852,441
Less accumulated depreciation (HEP: $(284,590) and $(244,850), respectively)	(1,331,821)	(1,181,902)
	3,977,258	3,670,539
Other assets: Turnaround costs	232,324	257,153
Goodwill (HEP: $288,991 and $288,991, respectively)	2,331,781	2,331,781
Intangibles and other (HEP: $129,969 and $73,928, respectively)	222,601	188,169
	2,786,706	2,777,103
Total assets	$9,071,637	$9,230,640
LIABILITIES AND EQUITY		
Current liabilities:		
Accounts payable (HEP: $11,236 and $17,881, respectively)	$926,625	$1,108,138
Income taxes payable	39,536	19,642
Accrued liabilities (HEP: $24,304 and $26,321, respectively)	126,292	106,214
Deferred income tax liabilities	—	17,409
Total current liabilities	1,092,453	1,251,403
Long-term debt (HEP: $951,067 and $867,579, respectively)	982,846	1,054,890
Deferred income taxes (HEP: $356 and $367, respectively)	636,437	646,870
Other long-term liabilities (HEP: $58,417 and $47,170, respectively)	178,217	176,758
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 September 30, 2015 and December 31, 2014	2,560	2,560
Additional capital	4,021,774	4,003,628
Retained earnings	3,375,226	2,778,577
Accumulated other comprehensive income	7,167	27,894
Common stock held in treasury, at cost – 70,957,479 and 59,876,776 shares as of September 30, 2015 and December 31, 2014, respectively	(1,785,559)	(1,289,075)
Total HollyFrontier stockholders' equity	5,621,168	5,523,584
Noncontrolling interest	560,516	577,135
Total equity	6,181,684	6,100,719
Total liabilities and equity	$9,071,637	$9,230,640

Parenthetical amounts represent asset and liability balances attributable to Holly Energy Partners, L.P. ("HEP") as of September 30, 2015 and December 31, 2014. HEP is a consolidated variable interest entity.

See accompanying notes.

Table of Content

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Sales and other revenues	$3,585,823	$5,317,555	$10,294,361	$15,481,208
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)	2,653,859	4,625,893	7,792,707	13,439,359
Lower of cost or market inventory valuation adjustment	225,451	—	83,425	—
	2,879,310	4,625,893	7,876,132	13,439,359
Operating expenses (exclusive of depreciation and amortization)	265,398	280,957	775,159	826,577
General and administrative expenses (exclusive of depreciation and amortization)	30,746	27,149	86,432	82,437
Depreciation and amortization	87,764	80,945	255,579	262,883
Total operating costs and expenses	3,263,218	5,014,944	8,993,302	14,611,256
Income from operations	322,605	302,611	1,301,059	869,952
Other income (expense):				
Earnings (loss) of equity method investments	1,269	(1,247)	(5,907)	(2,956)
Interest income	673	1,004	2,403	3,593
Interest expense	(11,102)	(11,038)	(31,813)	(33,521)
Loss on early extinguishment of debt	—	—	(1,370)	(7,677)
Gain (loss) on sale of assets	7,228	(556)	8,867	(556)
	(1,932)	(11,837)	(27,820)	(41,117)
Income before income taxes	320,673	290,774	1,273,239	828,835
Income tax provision:				
Current	215,381	91,867	509,956	294,331
Deferred	(105,315)	11,349	(63,172)	(2,169)
	110,066	103,216	446,784	292,162
Net income	210,607	187,558	826,455	536,673
Less net income attributable to noncontrolling interest	14,285	12,552	42,433	33,177
Net income attributable to HollyFrontier stockholders	$196,322	$175,006	$784,022	$503,496
Earnings per share attributable to HollyFrontier stockholders:				
Basic	$1.05	$0.88	$4.09	$2.54
Diluted	$1.04	$0.88	$4.09	$2.53
Cash dividends declared per common share	$0.33	$0.82	$0.98	$2.44
Average number of common shares outstanding:				
Basic	187,208	197,261	191,182	197,895
Diluted	187,344	197,535	191,282	198,096

See accompanying notes.

6

Table of Content

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

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
Net income	$210,607	$187,558	$826,455	$536,673
Other comprehensive income:				
Securities available-for-sale:				
Unrealized gain (loss) on marketable securities	166	(153)	217	(116)
Reclassification adjustments to net income on sale or maturity of marketable securities	—	(12)	(46)	(13)
Net unrealized gain (loss) on marketable securities	166	(165)	171	(129)
Hedging instruments:				
Change in fair value of cash flow hedging instruments	(357)	5,133	(7,590)	143,857
Reclassification adjustments to net income on settlement of cash flow hedging instruments	(9,248)	(13,844)	(27,683)	(31,710)
Amortization of unrealized loss attributable to discontinued cash flow hedges	270	270	810	810
Net unrealized gain (loss) on hedging instruments	(9,335)	(8,441)	(34,463)	112,957
Post-retirement benefit obligations:				
Loss on post-retirement healthcare plan	—	—	—	(89)
Retirement restoration plan loss reclassified to net income	—	422	—	422
Net change in post-retirement benefit obligations	—	422	—	333
Other comprehensive income (loss) before income taxes	(9,169)	(8,184)	(34,292)	113,161
Income tax expense (benefit)	(3,488)	(3,428)	(13,088)	43,694
Other comprehensive income (loss)	(5,681)	(4,756)	(21,204)	69,467
Total comprehensive income	204,926	182,802	805,251	606,140
Less noncontrolling interest in comprehensive income	14,127	13,225	41,956	33,455
Comprehensive income attributable to HollyFrontier stockholders	$190,799	$169,577	$763,295	$572,685

See accompanying notes.

Table of Content

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

	Nine Months Ended September 30, 2015	2014
Cash flows from operating activities:		
Net income	$826,455	$536,673
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	255,579	262,883
Lower of cost or market inventory valuation adjustment	83,425	—
Net loss of equity method investments, inclusive of distributions	8,282	5,268
(Gain) loss on sale of assets	(8,619)	556
(Gain) loss on early extinguishment of debt attributable to unamortized premium / discount	(3,788)	1,489
Deferred income taxes	(63,172)	(2,169)
Equity-based compensation expense	21,928	20,728
Change in fair value – derivative instruments	17,861	(12,199)
(Increase) decrease in current assets:		
Accounts receivable	68,021	8,530
Inventories	(85,318)	(225,698)
Income taxes receivable	11,719	76,488
Prepayments and other	(8,312)	24,719
Increase (decrease) in current liabilities:		
Accounts payable	(203,289)	109,912
Income taxes payable	19,894	—
Accrued liabilities	13,503	27,327
Turnaround expenditures	(55,905)	(32,236)
Other, net	5,077	3,662
Net cash provided by operating activities	903,341	805,933
Cash flows from investing activities:		
Additions to properties, plants and equipment	(416,611)	(307,476)
Additions to properties, plants and equipment – HEP	(57,286)	(61,657)
Purchase of equity method investment - HEP	(54,641)	—
Proceeds from sale of assets	15,831	14,711
Purchases of marketable securities	(402,984)	(762,224)
Sales and maturities of marketable securities	490,251	863,769
Other, net	—	5,021
Net cash used for investing activities	(425,440)	(247,856)
Cash flows from financing activities:		
Borrowings under credit agreement – HEP	443,000	538,600
Repayments under credit agreement – HEP	(360,000)	(346,600)
Redemption of senior notes	(155,156)	—
Redemption of senior notes – HEP	—	(156,188)
Purchase of treasury stock	(481,766)	(133,150)
Dividends	(187,372)	(485,766)

Distributions to noncontrolling interest	(61,366)	(58,473)
Excess tax benefit from equity-based compensation	—	4,482
Other, net	(3,495)	(5,059)
Net cash used for financing activities	(806,155)	(642,154)
Cash and cash equivalents:		
Decrease for the period	(328,254)	(84,077)
Beginning of period	567,985	940,103
End of period	$239,731	$856,026
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$40,608	$45,672
Income taxes	$484,516	$222,488

See accompanying notes.

Table of Content

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 September 30, 2015, 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 NK Asphalt Partners (“NK 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. HEP owns and operates logistic assets consisting of petroleum product and crude oil pipelines and terminal, tankage and loading rack facilities 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”), which owns a 427-mile, 12-inch refined products pipeline from Salt Lake City, Utah to Las Vegas, Nevada, together with terminal facilities in the Cedar City, Utah and North Las Vegas areas (the “UNEV Pipeline”); a 50% interest in Frontier Pipeline Company, which owns a 289-mile crude oil pipeline from Casper, Wyoming to Frontier Station, Utah (the "Frontier Pipeline"); and a 25% interest in SLC Pipeline LLC (the “SLC Pipeline”), which owns a 95-mile intrastate pipeline system that serves refineries in the Salt Lake City area.

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 September 30, 2015, the consolidated results of operations and comprehensive income for the three and nine months ended September 30, 2015 and 2014 and consolidated cash flows for the nine months ended September 30, 2015 and 2014 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, 2014 that has been filed with the SEC.

Our results of operations for the nine months ended September 30, 2015 are not necessarily indicative of the results of operations to be realized for the year ending December 31, 2015.

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 September 30, 2015 and $2.4 million at December 31, 2014.

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 September 30, 2015, there have been no impairments to goodwill.

We performed our annual goodwill impairment testing as of July 1, 2015, which entailed an assessment of our reporting unit fair values relative to their respective carrying values that were derived using a combination of both income and market approaches. Our income approach utilizes the discounted future expected cash flows. Our market approach, which includes both the guideline public company and guideline transaction methods, utilizes pricing multiples derived from historical market transactions of other like-kind assets. Our discounted cash flows reflect estimates of future cash flows based on both historical and forward crack-spreads, forecasted production levels, operating costs and capital expenditures. Our goodwill is allocated by reporting unit as follows: El Dorado, $1.7 billion; Cheyenne, $0.3 billion; and HEP, $0.3 billion. Based on our testing as of July 1, 2015, the fair value of our Cheyenne reporting unit exceeded its carrying cost by approximately 8%. The fair value of our El Dorado and HEP reporting units substantially exceeded their respective carrying values. As of September 30, 2015, 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 reasonably possible that at some future downturn in refining operations that the goodwill related to our Cheyenne Refinery will be determined to be impaired. Such impairment charges could be material.

New Accounting Pronouncements

Revenue Recognition
In May 2014, an accounting standard update (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 was formed to acquire, own and operate the petroleum product and crude oil pipeline and terminal, tankage and loading rack facilities that support our refining and marketing operations in the Mid-Continent, Southwest and Rocky Mountain regions of the United States. HEP also owns and operates refined product pipelines and terminals, located primarily in Texas, that serve Alon's refinery in Big Spring, Texas.

As of September 30, 2015, 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. See Note 16 for supplemental guarantor/non-guarantor financial information, including HEP balances included in these consolidated financial statements.

HEP has two primary customers (including us) and generates revenues by charging tariffs for transporting petroleum products and crude oil though 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 82% of HEP's total revenues for the nine months ended September 30, 2015. 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.

Frontier Pipeline Transaction
On August 31, 2015, HEP purchased a 50% interest in Frontier Pipeline Company, owner of the Frontier Pipeline, from an affiliate of Enbridge, Inc. for $54.6 million. Frontier Pipeline will continue to be operated by an affiliate of Plains All American Pipeline, L.P., which owns the remaining 50% interest. The 289-mile crude oil pipeline, which runs from Casper, Wyoming to Frontier Station, Utah, has a 72,000 barrels per day capacity. The Frontier Pipeline supplies Canadian and Rocky Mountain crudes to Salt Lake City area refiners through a connection to the SLC Pipeline.

El Dorado Asset Transaction
On November 1, 2015, HEP acquired from us newly constructed naphtha fractionation and hydrogen generation units at our El Dorado Refinery for cash consideration of $62.0 million. In connection with this transaction, we entered into 15-year tolling agreements containing minimum quarterly throughput commitments that provide minimum annualized payments to HEP of $15.3 million.

Transportation Agreements
HEP serves our refineries under long-term pipeline and terminal, tankage and throughput agreements expiring from 2019 through 2026. Under these agreements, we pay HEP fees to transport, store and throughput volumes of refined product and crude oil on HEP's pipeline and terminal, tankage and loading rack facilities 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 September 30, 2015, these agreements result in minimum annualized payments to HEP of $236.6 million.

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

NOTE 3: Financial Instruments

Our financial instruments consist of cash and cash equivalents, investments in marketable securities, 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.

Table of Contents
HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

- (Level 3) Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes valuation techniques that involve significant unobservable inputs.

The carrying amounts and estimated fair values of investments in marketable securities, derivative instruments and senior notes at September 30, 2015 and December 31, 2014 were as follows:

			Fair Value by Input Level		
Financial Instrument	Carrying Amount	Fair Value	Level 1	Level 2	Level 3
	(In thousands)				
September 30, 2015					
Assets:					
Marketable securities	$387,053	$387,053	$—	$387,053	$—
NYMEX futures contracts	5,064	5,064	5,064	—	—
Commodity price swaps	113,956	113,956	—	113,956	—
Forward contracts	2,496	2,496	—	2,496	—
Total assets	$508,569	$508,569	$5,064	$503,505	$—
Liabilities:					
Commodity price swaps	$140,194	$140,194	$—	$140,194	$—
HEP senior notes	297,067	288,000	—	288,000	—
HEP interest rate swaps	834	834	—	834	—
Total liabilities	$438,095	$429,028	$—	$429,028	$—
December 31, 2014					
Assets:					
Marketable securities	$474,110	$474,110	$—	$474,110	$—
NYMEX futures contracts	17,619	17,619	17,619	—	—
Commodity price swaps	208,296	208,296	—	208,296	—
HEP interest rate swaps	1,019	1,019	—	1,019	—
Total assets	$701,044	$701,044	$17,619	$683,425	$—
Liabilities:					
Commodity price swaps	$196,897	$196,897	$—	$196,897	$—
HollyFrontier senior notes	154,144	155,250	—	155,250	—
HEP senior notes	296,579	291,000	—	291,000	—
HEP interest rate swaps	1,065	1,065	—	1,065	—
Total liabilities	$648,685	$644,212	$—	$644,212	$—

Level 1 Financial 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 Financial Instruments
Investments in marketable securities and 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 marketable securities and 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 Financial 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.

Table of Contents
HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

The following table presents the changes in fair value of our Level 3 assets and liabilities (all related to derivative instruments) for the three and nine months ended September 30, 2015 and 2014:

Level 3 Financial Instruments	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
	(In thousands)			
Liability balance at beginning of period	$—	$(75,637)	$—	$(35,318)
Change in fair value:				
Recognized in other comprehensive income	—	178,511	3,852	65,816
Recognized in cost of products sold	—	11,085	—	12,970
Settlement date fair value of contractual maturities:				
Recognized in sales and other revenues	—	6,202	(3,852)	80,476
Recognized in cost of products sold	—	(4,251)	—	(8,034)
Asset balance at end of period	$—	$115,910	$—	$115,910

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 components of the basic and diluted per share computations for net income attributable to HollyFrontier stockholders:

	Three Months Ended September 30, 2015	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2015	Nine Months Ended September 30, 2014
	(In thousands, except per share data)			
Net income attributable to HollyFrontier stockholders	$196,322	$175,006	$784,022	$503,496
Participating securities' share in earnings	567	471	2,245	1,416
Net income attributable to common shares	$195,755	$174,535	$781,777	$502,080
Average number of shares of common stock outstanding	187,208	197,261	191,182	197,895
Effect of dilutive variable restricted shares and performance share units [1]	136	274	100	201
Average number of shares of common stock outstanding assuming dilution	187,344	197,535	191,282	198,096
Basic earnings per share	$1.05	$0.88	$4.09	$2.54
Diluted earnings per share	$1.04	$0.88	$4.09	$2.53
[1] Excludes anti-dilutive restricted and performance share units of:	263	195	335	214

NOTE 5: Stock-Based Compensation

As of September 30, 2015, we have two principal share-based compensation plans (collectively, the “Long-Term Incentive Compensation Plan”).

The compensation cost charged against income for these plans was $6.4 million and $6.0 million for the three months ended September 30, 2015 and 2014, respectively, and $18.9 million and $18.2 million for the nine months ended September 30, 2015 and 2014, respectively. Our accounting policy for the recognition of compensation expense for awards with pro-rata vesting is to expense the costs ratably over the vesting periods.

Table of Contents

HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

Additionally, HEP maintains a share-based compensation plan for Holly Logistic Services, L.L.C.'s non-employee directors and certain executives and employees. Compensation cost attributable to HEP's share-based compensation plan was $1.3 million and $0.8 million for the three months ended September 30, 2015 and 2014, respectively, and $3.0 million and $2.5 million for the nine months ended September 30, 2015 and 2014, respectively.

Restricted Stock and Restricted Stock Units

Under our Long-Term Incentive Compensation Plan, we grant certain officers and other key employees restricted stock and restricted stock unit awards with awards generally vesting over a period of one to three years. Restricted stock award recipients are generally entitled to all the rights of absolute ownership of the restricted shares from the date of grant including the right to vote the shares and to receive dividends. Upon vesting, restrictions on the restricted shares lapse at which time they convert to common shares. In addition, we grant non-employee directors restricted stock unit awards, which typically vest over a period of one year and are payable in stock. The fair value of each restricted stock and restricted stock unit award is measured based on the grant date market price of our common shares and is amortized over the respective vesting period.

A summary of restricted stock and restricted stock unit activity and changes during the nine months ended September 30, 2015 is presented below:

Restricted Stock and Restricted Stock Units	Grants	Weighted Average Grant Date Fair Value	Aggregate Intrinsic Value ($000)
Outstanding at January 1, 2015 (non-vested)	669,777	$44.12	
Granted	12,969	40.33	
Vesting (transfer/conversion to common stock)	(8,699)	44.08	
Forfeited	(16,166)	43.83	
Outstanding at September 30, 2015 (non-vested)	657,881	$44.05	$31,920

For the nine months ended September 30, 2015, 8,699 restricted stock and restricted stock units vested having a grant date fair value of $0.4 million. As of September 30, 2015, there was $9.8 million of total unrecognized compensation cost related to non-vested restricted stock and restricted stock unit grants. That cost is expected to be recognized over a weighted-average period of 1.1 years.

Performance Share Units

Under our Long-Term Incentive Compensation Plan, we grant certain officers and other key employees performance share units, which are payable in stock upon meeting certain criteria over the service period, and generally vest over a period of three years. Under the terms of our performance share unit grants, awards are subject to "financial performance" and "market performance" criteria. Financial performance is based on our financial performance compared to a peer group of independent refining companies, while market performance is based on the relative standing of total shareholder return achieved by HollyFrontier compared to peer group companies. The number of shares ultimately issued under these awards can range from zero to 200% of target award amounts. As of September 30, 2015, estimated share payouts for outstanding non-vested performance share unit awards averaged approximately 33% of target amounts.

A summary of performance share unit activity and changes during the nine months ended September 30, 2015 is presented below:

Performance Share Units	Grants
Outstanding at January 1, 2015 (non-vested)	725,054
Granted	4,242
Forfeited	(27,131)
Outstanding at September 30, 2015 (non-vested)	702,165

As of September 30, 2015, there was $12.4 million of total unrecognized compensation cost related to non-vested performance share units having a grant date fair value of $43.68 per unit. That cost is expected to be recognized over a weighted-average period of 1.3 years.

NOTE 6: Cash and Cash Equivalents and Investments in Marketable Securities

Our investment portfolio at September 30, 2015 consisted of cash, cash equivalents and investments in marketable securities.

We currently invest in marketable debt securities with the maximum maturity or put date of any individual issue generally not greater than one year from the date of purchase, which are usually held until maturity. All of these instruments are classified as available-for-sale. As a result, they are reported at fair value using quoted market prices. Interest income is recorded as earned. Unrealized gains and losses, net of related income taxes, are reported as a component of accumulated other comprehensive income. Upon sale or maturity, realized gains on our marketable debt securities are recognized as interest income. These gains are computed based on the specific identification of the underlying cost of the securities, net of unrealized gains and losses previously reported in other comprehensive income. Unrealized gains and losses on our available-for-sale securities are due to changes in market prices and are considered temporary.

The following is a summary of our marketable securities:

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss		Fair Value (Net Carrying Amount)
	(In thousands)				
September 30, 2015					
Certificates of deposit	$5,999	$4	$—		$6,003
Commercial paper	58,299	21	—		58,320
Corporate debt securities	86,657	13	(31	)	86,639
State and political subdivisions debt securities	236,075	58	(42	)	236,091
Total marketable securities	$387,030	$96	$(73	)	$387,053
December 31, 2014					
Certificates of deposit	$54,000	$10	$—		$54,010
Commercial paper	52,297	7	(4	)	52,300
Corporate debt securities	136,181	1	(94	)	136,088
State and political subdivisions debt securities	231,819	5	(112	)	231,712
Total marketable securities	$474,297	$23	$(210	)	$474,110

Interest income recognized on our marketable securities was $0.5 million for both the three months ended September 30, 2015 and 2014, and $1.4 million and $1.7 million for the nine months ended September 30, 2015 and 2014, respectively.

NOTE 7: Inventories

Inventory consists of the following components:

	September 30, 2015	December 31, 2014
	(In thousands)	
Crude oil	$540,992	$581,592
Other raw materials and unfinished products[1]	175,468	204,467
Finished products[2]	663,956	531,523
Lower of cost or market reserve	(480,903)	(397,478)
Process chemicals[3]	7,275	4,028
Repair and maintenance supplies and other	130,236	110,999
Total inventory	$1,037,024	$1,035,131

(1) Other raw materials and unfinished products include feedstocks and blendstocks, other than crude.
(2) Finished products include gasolines, jet fuels, diesels, lubricants, asphalts, LPG’s and residual fuels.
(3) Process chemicals include additives and other chemicals.

Inventories, which are valued at the lower of LIFO cost or market, reflect a valuation reserve of $480.9 million and $397.5 million at September 30, 2015 and December 31, 2014, respectively. The December 31, 2014 market reserve of $397.5 million was reversed due to the sale of inventory quantities that gave rise to the 2014 reserve. A new market reserve of $480.9 million was established as of September 30, 2015 based on market conditions and prices at that time. The effect of the change in lower of cost or market reserve was a $225.5 million and $83.4 million increase to cost of products sold for the three and nine months ended September 30, 2015, respectively.

NOTE 8: Environmental

Environmental costs are charged to operating expenses if they relate to an existing condition caused by past operations and do not contribute to current or future revenue generation. We have ongoing investigations of environmental matters at various locations as part of our assessment process to determine the amount of environmental obligation we may have, if any, with respect to these matters for which we have recorded the estimated cost of the studies. Liabilities are recorded when site restoration and environmental remediation, cleanup and other obligations are either known or considered probable and can be reasonably estimated. Such estimates are undiscounted and require judgment with respect to costs, time frame and extent of required remedial and cleanup activities and are subject to periodic adjustments based on currently available information. Recoveries of environmental costs through insurance, indemnification arrangements or other sources are included in other assets to the extent such recoveries are considered probable.

We expensed $3.0 million and zero for the three months ended September 30, 2015 and 2014, respectively, and $7.6 million and $1.3 million for the nine months ended September 30, 2015 and 2014, respectively, for environmental remediation obligations. The accrued environmental liability reflected in our consolidated balance sheets was $103.7 million and $104.5 million at September 30, 2015 and December 31, 2014, respectively, of which $84.0 million and $81.8 million, respectively, were classified as other long-term liabilities. These accruals include remediation and monitoring costs expected to be incurred over an extended period of time (up to 30 years for certain projects). The amount of our accrued liability could increase in the future when the results of ongoing investigations become known, are considered probable and can be reasonably estimated.

NOTE 9: Debt

HollyFrontier Credit Agreement
We have a $1 billion senior unsecured revolving credit facility maturing in July 2019 (the "HollyFrontier Credit Agreement"), which may be used for revolving credit loans and letters of credit from time to time and is available to fund general corporate purposes. Indebtedness under the HollyFrontier Credit Agreement is recourse to HollyFrontier and guaranteed by certain of our wholly-owned subsidiaries. At September 30, 2015, we were in compliance with all covenants, had no outstanding borrowings and had outstanding letters of credit totaling $6.0 million under the HollyFrontier Credit Agreement.

HEP Credit Agreement
HEP has an $850 million senior secured revolving credit facility that matures in November 2018 (the "HEP Credit Agreement") and is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is also available to fund letters of credit up to a $50 million sub-limit. At September 30, 2015, HEP was in compliance with all of its covenants, had outstanding borrowings of $654.0 million and no outstanding letters of credit under the HEP Credit Agreement. In April 2015, HEP amended its credit agreement, increasing the size of the credit facility from $650 million to $850 million.

HEP's obligations under the HEP Credit Agreement are collateralized by substantially all of HEP's assets. Indebtedness under the HEP Credit Agreement involves recourse to HEP Logistics Holdings, L.P., its general partner, and is guaranteed by HEP's wholly-owned subsidiaries. Any recourse to the 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. HEP's creditors have no recourse to our other assets. Furthermore, our creditors have no recourse to the assets of HEP and its consolidated subsidiaries.

HollyFrontier Senior Notes
In June 2015, we redeemed our $150.0 million aggregate principal amount of 6.875% senior notes maturing November 2018 at a redemption cost of $155.2 million at which time we recognized a $1.4 million early extinguishment loss consisting of a $5.2 million debt redemption premium, net of an unamortized premium of $3.8 million.

HollyFrontier Financing Obligation
We have a financing obligation that relates to a sale and lease-back of certain crude oil tankage that we sold to an affiliate of Plains All American Pipeline, L.P. ("Plains") in October 2009 for $40.0 million. Monthly lease payments are recorded as a reduction in principal over the 15-year lease term ending in 2024.

HEP Senior Notes
HEP's 6.5% senior notes ($300 million aggregate principal amount maturing March 2020) (the "HEP Senior Notes") are unsecured and impose certain restrictive covenants, including limitations on HEP's 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 HEP Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default exists, HEP will not be subject to many of the foregoing covenants. Additionally, HEP has certain redemption rights under the HEP Senior Notes.

In March 2014, HEP redeemed its $150.0 million aggregate principal amount of 8.25% senior notes maturing March 2018 at a redemption cost of $156.2 million, at which time HEP recognized a $7.7 million early extinguishment loss consisting of a $6.2 million debt redemption premium and unamortized discount and financing costs of $1.5 million. HEP funded the redemption with borrowings under the HEP Credit Agreement.

Indebtedness under the HEP Senior Notes involves recourse to HEP Logistics Holdings, L.P., its general partner, and is guaranteed by HEP’s wholly-owned subsidiaries. However, any recourse to the 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. HEP’s creditors have no recourse to our other assets. Furthermore, our creditors have no recourse to the assets of HEP and its consolidated subsidiaries.

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

	September 30, 2015	December 31, 2014
	(In thousands)	
6.875% Senior Notes		
Principal	$—	$150,000
Unamortized premium	—	4,144
	—	154,144
Financing Obligation	31,779	33,167
Total HollyFrontier long-term debt	31,779	187,311
HEP Credit Agreement	654,000	571,000
HEP 6.5% Senior Notes		
Principal	300,000	300,000
Unamortized discount	(2,933)	(3,421)
	297,067	296,579
Total HEP long-term debt	951,067	867,579
Total long-term debt	$982,846	$1,054,890

We capitalized interest attributable to construction projects of $0.1 million and $2.9 million for the three months ended September 30, 2015 and 2014, respectively, and $5.5 million and $9.0 million for the nine months ended September 30, 2015 and 2014, respectively.

NOTE 10: Derivative Instruments and Hedging Activities

Commodity Price Risk Management

Our primary market risk is commodity price risk. We are exposed to market risks related to the volatility in crude oil and refined products, as well as volatility in the price of natural gas used in our refining operations. We periodically enter into derivative contracts in the form of commodity price swaps, forward purchase and sales and futures contracts to mitigate price exposure with respect to:

- our inventory positions;
- natural gas purchases;
- costs of crude oil and related grade differentials;
- prices of refined products; and
- our refining margins.

Accounting Hedges

We have swap contracts serving as cash flow hedges against price risk on forecasted purchases of natural gas and WTI crude oil and forecasted sales of refined product. We also have forward sales contracts that lock in the prices of future sales of refined product. These contracts have been designated as accounting hedges and are measured at fair value with offsetting adjustments (gains/losses) recorded directly to other comprehensive income. These fair value adjustments are later reclassified to earnings as the hedging instruments mature. On a quarterly basis, hedge ineffectiveness is measured by comparing the change in fair value of the swap contracts against the expected future cash inflows/outflows on the respective transaction being hedged. Any hedge ineffectiveness is also recognized in earnings.

Table of Contents
HOLLYFRONTIER CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited) Continued

The following table presents the pre-tax effect on other comprehensive income ("OCI") and earnings due to fair value adjustments and maturities of commodity price swaps and forward sales under hedge accounting:

	Unrealized Gain (Loss) Recognized in OCI	Gain (Loss) Recognized in Earnings Due to Settlements		Gain (Loss) Attributable to Hedge Ineffectiveness Recognized in Earnings	
		Location	Amount	Location	Amount
	(In thousands)				
Three Months Ended September 30, 2015					
Change in fair value	$430	Sales and other revenues	$57,513		
Gain reclassified to earnings due to settlements	(9,774)	Cost of products sold	(44,023)		
Amortization of discontinued hedges reclassified to earnings	270	Operating expenses	(3,986)	Cost of products sold	$638
Total	$(9,074)		$9,504		$638
Three Months Ended September 30, 2014					
Change in fair value	$4,580	Sales and other revenues	$(6,202)	Sales and other revenues	$1,498
Gain reclassified to earnings due to settlements	(14,400)	Cost of products sold	20,776	Cost of products sold	(6,189)
Amortization of discontinued hedges reclassified to earnings	270	Operating expenses	(444)	Operating expenses	(99)
Total	$(9,550)		$14,130		$(4,790)
Nine Months Ended September 30, 2015					
Change in fair value	$(5,217)	Sales and other revenues	$156,445	Sales and other revenues	$(274)
Gain reclassified to earnings due to settlements	(29,268)	Cost of products sold	(115,756)	Cost of products sold	4,376
Amortization of discontinued hedge reclassified to earnings	810	Operating expenses	(12,231)	Operating expenses	547
Total	$(33,675)		$28,458		$4,649
Nine Months Ended September 30, 2014					
Change in fair value	$145,046	Sales and other revenues	$(80,475)	Sales and other revenues	$1,498
Gain reclassified to earnings due to settlements	(33,357)	Cost of products sold	111,217	Cost of products sold	(6,189)
	810		1,805		(905)

Amortization of discontinued hedge reclassified to earnings		Operating expenses		Operating expenses		
Total	$112,499		$32,547		$(5,596	)

As of September 30, 2015, we have the following notional contract volumes related to outstanding derivative instruments serving as cash flow hedges against price risk on forecasted purchases of natural gas and crude oil and sales of refined products:

		Notional Contract Volumes by Year of Maturity			
Derivative Instrument	Total Outstanding Notional	2015	2016	2017	Unit of Measure
Natural gas - long	21,600,000	2,400,000	9,600,000	9,600,000	MMBTU
WTI crude oil - long	2,760,000	2,760,000	—	—	Barrels
Ultra-low sulfur diesel - short	2,760,000	2,760,000	—	—	Barrels
Forward diesel sales	225,000	225,000	—	—	Barrels

In 2013, we dedesignated certain commodity price swaps (long positions) that previously received hedge accounting treatment. These contracts now serve as economic hedges against price risk on forecasted natural gas purchases totaling 21,600,000 MMBTU's to be purchased ratably through 2017. As of September 30, 2015, we have an unrealized loss of $2.4 million classified in accumulated other comprehensive income that relates to the application of hedge accounting prior to dedesignation that is amortized as a charge to operating expenses as the contracts mature.

Economic Hedges

We also have swap contracts that serve as economic hedges (derivatives used for risk management, but not designated as accounting hedges) to fix our purchase price on forecasted purchases of WTI crude oil, and to lock in basis spread differentials on forecasted purchases of crude oil and natural gas. Also, we have NYMEX futures contracts to lock in prices on forecasted purchases of inventory. These contracts are measured at fair value with offsetting adjustments (gains/losses) recorded directly to income.

The following table presents the pre-tax effect on income due to maturities and fair value adjustments of our economic hedges:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Location of Gain (Loss) Recognized in Income	2015	2014	2015	2014
	(In thousands)			
Cost of products sold	$13,872	$27,773	$41,445	$3,367
Operating expenses	(6,528)	3		