LOEWS CORP
Form 10-Q
July 30, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2013

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 1-6541

LOEWS CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**13-2646102**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

667 Madison Avenue, New York, N.Y. 10065-8087

(Address of principal executive offices) (Zip Code)

(212) 521-2000

(Registrant s telephone number, including area code)

NOT APPLICABLE

(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 ___X___ 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 ___X___ No ________ Not Applicable ________

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. (Check one):

Large accelerated filer _X_ 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 ___X___

Class	Outstanding at July 19, 2013
Common stock, $0.01 par value	387,316,565 shares

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Loews Corporation and Subsidiaries

CONSOLIDATED CONDENSED BALANCE SHEETS

(Unaudited)

	June 30, 2013	December 31, 2012
(Dollar amounts in millions, except per share data)		
Assets:		
Investments:		
Fixed maturities, amortized cost of $39,114 and $38,324	**$ 41,595**	$ 42,765
Equity securities, cost of $903 and $893	**856**	898
Limited partnership investments	**3,317**	3,090
Other invested assets, primarily mortgage loans	**473**	460
Short term investments	**6,091**	5,835
Total investments	**52,332**	53,048
Cash	**166**	228
Receivables	**9,519**	9,366
Property, plant and equipment	**14,525**	13,935
Goodwill	**989**	996
Other assets	**1,618**	1,538
Deferred acquisition costs of insurance subsidiaries	**650**	598
Separate account business	**247**	312
Total assets	**$ 80,046**	$ 80,021
Liabilities and Equity:		
Insurance reserves:		
Claim and claim adjustment expense	**$ 24,339**	$ 24,763
Future policy benefits	**10,787**	11,475
Unearned premiums	**3,869**	3,610
Policyholders funds	**133**	157
Total insurance reserves	**39,128**	40,005
Payable to brokers	**520**	205
Short term debt	**33**	19
Long term debt	**10,039**	9,191
Deferred income taxes	**749**	840
Other liabilities	**4,688**	4,773
Separate account business	**247**	312

Total liabilities	**55,404**	55,345
Preferred stock, $0.10 par value:		
Authorized 100,000,000 shares		
Common stock, $0.01 par value:		
Authorized 1,800,000,000 shares		
Issued 392,282,321 and 392,054,766 shares	**4**	4
Additional paid-in capital	**3,643**	3,595
Retained earnings	**15,654**	15,192
Accumulated other comprehensive income	**37**	678
	19,338	19,469
Less treasury stock, at cost (4,276,200 and 249,600 shares)	**(187)**	(10)
Total shareholders equity	**19,151**	19,459
Noncontrolling interests	**5,491**	5,217
Total equity	**24,642**	24,676
Total liabilities and equity	**$ 80,046**	$ 80,021

See accompanying Notes to Consolidated Condensed Financial Statements.

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Loews Corporation and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	**2013**	2012
(In millions, except per share data)				
Revenues:				
Insurance premiums	**$ 1,800**	$ 1,668	**$ 3,564**	$ 3,317
Net investment income	**579**	386	**1,220**	1,112
Investment gains (losses):				
Other-than-temporary impairment losses	**(16)**	(12)	**(34)**	(27)
Portion of other-than-temporary impairment losses recognized in Other comprehensive income (loss)		(11)		(23)
Net impairment losses recognized in earnings	**(16)**	(23)	**(34)**	(50)
Other net investment gains	**2**	43	**44**	102
Total investment gains (losses)	**(14)**	20	**10**	52
Contract drilling revenues	**745**	726	**1,445**	1,481
Other	**615**	588	**1,220**	1,170
Total	**3,725**	3,388	**7,459**	7,132
Expenses:				
Insurance claims and policyholders benefits	**1,521**	1,348	**2,950**	2,729
Amortization of deferred acquisition costs	**335**	309	**663**	604
Contract drilling expenses	**369**	405	**744**	802
Other operating expenses (Note 1)	**807**	1,001	**1,789**	1,820
Interest	**112**	111	**220**	222
Total	**3,144**	3,174	**6,366**	6,177
Income before income tax	**581**	214	**1,093**	955
Income tax expense	**(169)**	(16)	**(283)**	(238)
Net income	**412**	198	**810**	717
Amounts attributable to noncontrolling interests	**(143)**	(142)	**(299)**	(294)
Net income attributable to Loews Corporation	**$ 269**	$ 56	**$ 511**	$ 423
Basic net income per share	**$ 0.69**	$ 0.14	**$ 1.31**	$ 1.07

Diluted net income per share	**$ 0.69**	$ 0.14	**$ 1.31**	$ 1.06
Dividends per share	**$ 0.0625**	$ 0.0625	**$ 0.125**	$ 0.125
Weighted-average shares outstanding:				
Shares of common stock	**388.79**	396.40	**390.08**	396.59
Dilutive potential shares of common stock	**0.83**	0.73	**0.80**	0.71
Total weighted-average shares outstanding assuming dilution	**389.62**	397.13	**390.88**	397.30

See accompanying Notes to Consolidated Condensed Financial Statements.

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Loews Corporation and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	**2013**	2012
(In millions)				
Net income	**$ 412**	$ 198	**$ 810**	$ 717
Other comprehensive income (loss), after tax				
Changes in:				
Net unrealized gains (losses) on investments with other-than-temporary impairments	**(8)**	(3)	**6**	37
Net other unrealized gains (losses) on investments	**(585)**	120	**(647)**	337
Total unrealized gains (losses) on available-for-sale investments	**(593)**	117	**(641)**	374
Unrealized gains (losses) on cash flow hedges	**10**	(2)	**(11)**	13
Pension liability	**5**	4	**9**	11
Foreign currency	**(13)**	(19)	**(74)**	2
Other comprehensive income (loss)	**(591)**	100	**(717)**	400
Comprehensive income (loss)	**(179)**	298	**93**	1,117
Amounts attributable to noncontrolling interests	**(83)**	(150)	**(225)**	(333)
Total comprehensive income (loss) attributable to Loews Corporation	**$ (262)**	$ 148	**$ (132)**	$ 784

See accompanying Notes to Consolidated Condensed Financial Statements.

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Loews Corporation and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF EQUITY

(Unaudited)

		Loews Corporation Shareholders					
(In millions)	Total	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury	Noncontrolling Interests
Balance, January 1, 2012	$ 23,203	$ 4	$ 3,494	$ 14,890	$ 384	$ -	$ 4,431
Net income	717			423			294
Other comprehensive income	400				361		39
Dividends paid	(266)			(50)			(216)
Issuance of equity securities by subsidiary	222		36		1		185
Purchase of Loews treasury stock	(51)					(51)	
Issuance of Loews common stock	5		5				
Stock-based compensation	11		10				1
Other	-		(2)				2
Balance, June 30, 2012	$ 24,241	$ 4	$ 3,543	$ 15,263	$ 746	$ (51)	$ 4,736
Balance, January 1, 2013	**$ 24,676**	**$ 4**	**$ 3,595**	**$ 15,192**	**$ 678**	**$ (10)**	**$ 5,217**
Net income	**810**			**511**			**299**
Other comprehensive loss	**(717)**				**(643)**		**(74)**
Dividends paid	**(292)**			**(49)**			**(243)**
Issuance of equity securities by subsidiary	**337**		**51**		**2**		**284**
	(177)					**(177)**	

	Total	Common Stock	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Common Stock Held in Treasury	Noncontrolling Interests
Purchase of Loews treasury stock							
Issuance of Loews common stock	**3**		**3**				
Stock-based compensation	**7**		**(6)**				**13**
Other	**(5)**						**(5)**
Balance, June 30, 2013	**$ 24,642**	**$ 4**	**$ 3,643**	**$ 15,654**	**$ 37**	**$ (187)**	**$ 5,491**

See accompanying Notes to Consolidated Condensed Financial Statements.

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Loews Corporation and Subsidiaries

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS

(Unaudited)

Six Months Ended June 30	**2013**	2012
(In millions)		
Operating Activities:		
Net income	**$ 810**	$ 717
Adjustments to reconcile net income to net cash provided (used) by operating activities, net	**613**	673
Changes in operating assets and liabilities, net:		
Receivables	**(180)**	257
Deferred acquisition costs	**(43)**	(17)
Insurance reserves	**198**	121
Other assets	**(70)**	(81)
Other liabilities	**54**	(87)
Trading securities	**(879)**	(477)
Net cash flow operating activities	**503**	1,106
Investing Activities:		
Purchases of fixed maturities	**(5,656)**	(5,169)
Proceeds from sales of fixed maturities	**3,143**	3,303
Proceeds from maturities of fixed maturities	**1,820**	1,566
Purchases of equity securities	**(33)**	(27)
Proceeds from sales of equity securities	**60**	61
Purchases of limited partnership investments	**(203)**	(83)
Proceeds from sales of limited partnership investments	**169**	115
Purchases of property, plant and equipment	**(1,150)**	(869)
Dispositions	**24**	151
Change in short term investments	**616**	(116)
Other, net	**(83)**	(90)
Net cash flow investing activities	**(1,293)**	(1,158)
Financing Activities:		
Dividends paid	**(49)**	(50)
Dividends paid to noncontrolling interests	**(243)**	(216)
Purchases of treasury shares	**(180)**	(51)
Issuance of common stock	**3**	5
Proceeds from sale of subsidiary stock	**370**	246
Principal payments on debt	**(742)**	(1,246)
Issuance of debt	**1,598**	1,375
Other, net	**(23)**	(4)

Net cash flow financing activities		**734**		59
Effect of foreign exchange rate on cash		**(6)**		
Net change in cash		**(62)**		7
Cash, beginning of period		**228**		129
Cash, end of period	**$**	**166**	$	136

See accompanying Notes to Consolidated Condensed Financial Statements.

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Loews Corporation and Subsidiaries

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

Loews Corporation is a holding company. Its subsidiaries are engaged in the following lines of business: commercial property and casualty insurance (CNA Financial Corporation (CNA), a 90% owned subsidiary); the operation of offshore oil and gas drilling rigs (Diamond Offshore Drilling, Inc. (Diamond Offshore), a 50.4% owned subsidiary); transportation and storage of natural gas and natural gas liquids and gathering and processing of natural gas (Boardwalk Pipeline Partners, LP (Boardwalk Pipeline), a 53% owned subsidiary); exploration, production and marketing of natural gas and oil (including condensate and natural gas liquids), (HighMount Exploration & Production LLC (HighMount), a wholly owned subsidiary); and the operation of a chain of hotels (Loews Hotels Holding Corporation (Loews Hotels), a wholly owned subsidiary). Unless the context otherwise requires, the terms Company, Loews and Registrant as used herein mean Loews Corporation excluding its subsidiaries and the term Net income (loss) attributable to Loews Corporation as used herein means Net income (loss) attributable to Loews Corporation shareholders.

In the opinion of management, the accompanying unaudited Consolidated Condensed Financial Statements reflect all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of June 30, 2013 and December 31, 2012 and the results of operations and comprehensive income for the three and six months ended June 30, 2013 and 2012 and changes in shareholders equity and cash flows for the six months ended June 30, 2013 and 2012.

Net income for the second quarter and first half of each of the years is not necessarily indicative of net income for that entire year.

Reference is made to the Notes to Consolidated Financial Statements in the 2012 Annual Report on Form 10-K which should be read in conjunction with these Consolidated Condensed Financial Statements.

The Company presents basic and diluted net income per share on the Consolidated Condensed Statements of Income. Basic net income per share excludes dilution and is computed by dividing net income attributable to common stock by the weighted average number of common shares outstanding for the period. Diluted net income per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Stock appreciation rights (SARs) of 1.4 million, 1.9 million, 1.7 million and 2.3 million shares were not included in the diluted weighted average shares amount for the three and six months ended June 30, 2013 and 2012 due to the exercise price being greater than the average stock price.

Bluegrass Project In the second quarter of 2013, Boardwalk Pipeline executed an agreement with the Williams Companies, Inc. (Williams) to continue the development process for the Bluegrass Project, a project that would transport natural gas liquids from the Marcellus and Utica shale plays to the petrochemical and export complex in the U.S. Gulf Coast region, and related fractionation and storage facilities. In connection with the transaction, Boardwalk Pipeline and Boardwalk Pipelines Holding Corp. (BPHC), a wholly owned subsidiary of the Company, have entered into separate joint venture arrangements for purposes of funding the project. Boardwalk Pipeline and BPHC have contributed a total of $25 million to the project as of June 30, 2013. The approval of funding any additional capital for the project is dependent on, among other conditions, execution of customer contracts sufficient to support the project and the parties receipt of all necessary board and regulatory approvals.

Impairment of Natural Gas and Oil Properties Results for the six months ended June 30, 2013, include a first quarter non-cash ceiling test impairment charge of $145 million ($92 million after tax) related to the carrying value of HighMount s natural gas and oil properties. For the three and six months ended June 30, 2012, HighMount recorded non-cash ceiling test impairment charges of $222 million and $266 million ($142 million and $170 million after tax). The impairments were recorded within Other operating expenses and as credits to Accumulated depreciation, depletion and amortization. The 2013 write-down was primarily attributable to reduced average natural gas liquids (NGL) and oil prices used in the ceiling test calculations and negative reserve revisions. Had the effects of HighMount s cash flow hedges not been considered in calculating the ceiling limitation, the impairments

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would have been $195 million ($124 million after tax) for 2013, and $266 million and $335 million ($170 million and $214 million after tax) for the three and six months ended June 30, 2012. In periods which HighMount took ceiling test impairment charges, HighMount performed a goodwill impairment test. HighMount also performed its annual goodwill impairment test as of April 30, 2013 and 2012. No impairment charges were required as a result of either the annual or interim period testing.

2. Investments

Net investment income is as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	**2013**	2012
(In millions)				
Fixed maturity securities	**$ 498**	$ 505	**$ 997**	$ 1,021
Short term investments	**1**	4	**3**	7
Limited partnership investments	**84**	(43)	**230**	100
Equity securities	**3**	2	**6**	6
Income (loss) from trading portfolio (a)	**1**	(74)	**(2)**	(4)
Other	**6**	7	**12**	11
Total investment income	**593**	401	**1,246**	1,141
Investment expenses	**(14)**	(15)	**(26)**	(29)
Net investment income	**$ 579**	$ 386	**$ 1,220**	$ 1,112

(a) Includes net unrealized gains (losses) related to changes in fair value on trading securities still held of $(30), $(90), $(43) and $(60) for the three and six months ended June 30, 2013 and 2012.

Investment gains (losses) are as follows:

Fixed maturity securities	**$ (5)**	$ 17	**$ 27**	$ 47
Equity securities	**(2)**		**(15)**	1
Derivative instruments	**(5)**	(1)	**(3)**	(2)
Short term investments and other	**(2)**	4	**1**	6
Investment gains (losses) (a)	**$ (14)**	$ 20	**$ 10**	$ 52

(a) Includes gross realized gains of $42, $51, $88 and $123 and gross realized losses of $49, $34, $76 and $75 on available-for-sale securities for the three and six months ended June 30, 2013 and 2012.

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The components of other-than-temporary impairment (OTTI) losses recognized in earnings by asset type are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	**2013**	2012
(In millions)				
Fixed maturity securities available-for-sale:				
Corporate and other bonds	**$ 5**	$ 6	**$ 8**	$ 16
Asset-backed:				
Residential mortgage-backed	**3**	15	**3**	29
Other asset-backed	**1**		**1**	
Total asset-backed	**4**	15	**4**	29
U.S. Treasury and obligations of government-sponsored enterprises				1
Total fixed maturities available-for-sale	**9**	21	**12**	46
Equity securities available-for-sale:				
Common stock	**2**	2	**2**	4
Preferred stock	**5**		**20**	
Total equity securities available-for-sale	**7**	2	**22**	4
Net OTTI losses recognized in earnings	**$ 16**	$ 23	**$ 34**	$ 50

The amortized cost and fair values of securities are as follows:

June 30, 2013	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Unrealized OTTI Losses (Gains)
(In millions)					
Fixed maturity securities:					
Corporate and other bonds	**$ 20,079**	**$ 1,826**	**$ 147**	**$21,758**	
States, municipalities and political subdivisions	**10,098**	**814**	**173**	**10,739**	
Asset-backed:					
Residential mortgage-backed	**5,031**	**153**	**88**	**5,096**	**$ (37)**
Commercial mortgage-backed	**1,941**	**95**	**27**	**2,009**	**(3)**
Other asset-backed	**933**	**16**	**2**	**947**	
Total asset-backed	**7,905**	**264**	**117**	**8,052**	**(40)**
U.S. Treasury and obligations of government-sponsored enterprises	**167**	**9**		**176**	

Foreign government	**528**	**17**	**1**	**544**	
Redeemable preferred stock	**121**	**13**	**2**	**132**	
Fixed maturities available-for-sale	**38,898**	**2,943**	**440**	**41,401**	**(40)**
Fixed maturities, trading	**216**		**22**	**194**	
Total fixed maturities	**39,114**	**2,943**	**462**	**41,595**	**(40)**
Equity securities:					
Common stock	**47**	**10**		**57**	
Preferred stock	**138**	**4**		**142**	
Equity securities available-for-sale	**185**	**14**	**-**	**199**	**-**
Equity securities, trading	**718**	**71**	**132**	**657**	
Total equity securities	**903**	**85**	**132**	**856**	**-**
Total	**$ 40,017**	**$ 3,028**	**$ 594**	**$42,451**	**$ (40)**

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December 31, 2012	Cost or Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	Unrealized OTTI Losses (Gains)
Fixed maturity securities:					
Corporate and other bonds	$ 19,530	$ 2,698	$ 21	$ 22,207	
States, municipalities and political subdivisions	9,372	1,455	44	10,783	
Asset-backed:					
Residential mortgage-backed	5,745	246	71	5,920	$ (28)
Commercial mortgage-backed	1,692	147	17	1,822	(3)
Other asset-backed	929	23		952	
Total asset-backed	8,366	416	88	8,694	(31)
U.S. Treasury and obligations of government-sponsored enterprises	172	11	1	182	
Foreign government	588	25		613	
Redeemable preferred stock	113	13	1	125	
Fixed maturities available-for-sale	38,141	4,618	155	42,604	(31)
Fixed maturities, trading	183		22	161	
Total fixed maturities	38,324	4,618	177	42,765	(31)
Equity securities:					
Common stock	38	14		52	
Preferred stock	190	7		197	
Equity securities available-for-sale	228	21	-	249	-
Equity securities, trading	665	80	96	649	
Total equity securities	893	101	96	898	-
Total	$ 39,217	$ 4,719	$ 273	$ 43,663	$ (31)

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The net unrealized gains on investments included in the tables above are recorded as a component of Accumulated Other Comprehensive Income (AOCI). When presented in AOCI, these amounts are net of tax and noncontrolling interests and any required Shadow Adjustments. At June 30, 2013 and December 31, 2012, the net unrealized gains on investments included in AOCI were net of Shadow Adjustments of $794 million and $1.4 billion. To the extent that unrealized gains on fixed income securities supporting certain products within CNA s Life & Group Non-Core Segment would result in a premium deficiency if realized, a related decrease in Deferred acquisition costs, and/or increase in Insurance reserves is recorded, net of tax and noncontrolling interests, as a reduction of net unrealized gains (losses) through Other comprehensive income (Shadow Adjustments).

The available-for-sale securities in a gross unrealized loss position are as follows:

	Less than 12 Months		12 Months or Longer		Total	
June 30, 2013	**Estimated Fair Value**	**Gross Unrealized Losses**	**Estimated Fair Value**	**Gross Unrealized Losses**	**Estimated Fair Value**	**Gross Unrealized Losses**
(In millions)						
Fixed maturity securities:						
Corporate and other bonds	**$ 3,478**	**$ 143**	**$ 33**	**$ 4**	**$ 3,511**	**$ 147**
States, municipalities and political subdivisions	**2,075**	**130**	**119**	**43**	**2,194**	**173**
Asset-backed:						
Residential mortgage-backed	**1,462**	**33**	**321**	**55**	**1,783**	**88**
Commercial mortgage-backed	**593**	**23**	**79**	**4**	**672**	**27**
Other asset-backed	**235**	**2**			**235**	**2**
Total asset-backed	**2,290**	**58**	**400**	**59**	**2,690**	**117**
Foreign government	**65**	**1**			**65**	**1**
Redeemable preferred stock	**39**	**2**			**39**	**2**
Total	**$ 7,947**	**$ 334**	**$ 552**	**$ 106**	**$ 8,499**	**$ 440**
December 31, 2012						
Fixed maturity securities:						
Corporate and other bonds	$ 846	$ 13	$ 108	$ 8	$ 954	$ 21
States, municipalities and political subdivisions	254	5	165	39	419	44
Asset-backed:						
Residential mortgage-backed	583	5	452	66	1,035	71
Commercial mortgage-backed	85	2	141	15	226	17
Total asset-backed	668	7	593	81	1,261	88
U.S. Treasury and obligations of government-sponsored enterprises	23	1			23	1
Redeemable preferred stock	28	1			28	1

Total	$ 1,819	$ 27	$ 866	$ 128	$ 2,685	$ 155

The amount of pretax net realized gains (losses) on available-for-sale securities reclassified out of AOCI into earnings was $(7) million, $15 million, $12 million and $47 million for the three and six months ended June 30, 2013 and 2012.

Based on current facts and circumstances, the Company believes the unrealized losses presented in the table above are primarily attributable to broader economic conditions, changes in interest rates and credit spreads, market illiquidity and other market factors, but are not indicative of the ultimate collectibility of the current amortized cost of the securities. The investments with longer duration, primarily included within the states, municipalities and political subdivision asset category, were more significantly impacted by changes in market interest rates. The Company has no current intent to sell these securities, nor is it more likely than not that it will be required to sell prior to recovery of amortized cost; accordingly, the Company has determined that there are no additional OTTI losses to be recorded at June 30, 2013.

The following table summarizes the activity for the three and six months ended June 30, 2013 and 2012 related to the pretax credit loss component reflected in Retained earnings on fixed maturity securities still held at June 30, 2013 and 2012 for which a portion of an OTTI loss was recognized in Other comprehensive income.

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2013	2012	**2013**	2012
(In millions)				
Beginning balance of credit losses on fixed maturity securities	**$ 92**	$ 100	**$ 95**	$ 92
Additional credit losses for securities for which an OTTI loss was previously recognized	**1**	10	**1**	21
Credit losses for securities for which an OTTI loss was not previously recognized		1		2
Reductions for securities sold during the period	**(4)**	(4)	**(7)**	(8)
Reductions for securities the Company intends to sell or more likely than not will be required to sell		(8)		(8)
Ending balance of credit losses on fixed maturity securities	**$ 89**	$ 99	**$ 89**	$ 99

Contractual Maturity

The following table summarizes available-for-sale fixed maturity securities by contractual maturity at June 30, 2013 and December 31, 2012. Actual maturities may differ from contractual maturities because certain securities may be called or prepaid with or without call or prepayment penalties. Securities not due at a single date are allocated based on weighted average life.

	June 30, 2013		December 31, 2012	
	Cost or Amortized Cost	**Estimated Fair Value**	Cost or Amortized Cost	Estimated Fair Value
(In millions)				
Due in one year or less	**$ 2,105**	**$ 2,153**	$ 1,648	$ 1,665
Due after one year through five years	**11,450**	**12,078**	13,603	14,442
Due after five years through ten years	**10,613**	**10,981**	8,726	9,555
Due after ten years	**14,730**	**16,189**	14,164	16,942
Total	**$ 38,898**	**$ 41,401**	$ 38,141	$ 42,604

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Investment Commitments

As of June 30, 2013, the Company had committed approximately $372 million to future capital calls from various third-party limited partnership investments in exchange for an ownership interest in the related partnerships.

The Company invests in various privately placed debt securities, including bank loans, as part of its overall investment strategy and has committed to additional future purchases, sales and funding. As of June 30, 2013, the Company had commitments to purchase or fund additional amounts of $160 million and sell $150 million under the terms of such securities.

3. Fair Value

Fair value is the price that would be received upon sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy is used in selecting inputs, with the highest priority given to Level 1, as these are the most transparent or reliable:

Level 1 Quoted prices for identical instruments in active markets.

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets.

Level 3 Valuations derived from valuation techniques in which one or more significant inputs are not observable.

The type of financial instruments being measured and the methodologies and inputs used at June 30, 2013 were consistent with those disclosed in the Annual Report on Form 10-K for the year ended December 31, 2012.

Prices may fall within Level 1, 2 or 3 depending upon the methodologies and inputs used to estimate fair value for each specific security. In general, the Company seeks to price securities using third party pricing services. Securities not priced by pricing services are submitted to independent brokers for valuation and, if those are not available, internally developed pricing models are used to value assets using methodologies and inputs the Company believes market participants would use to value the assets. Prices obtained from third-party pricing services or brokers are not adjusted by the Company.

The Company performs control procedures over information obtained from pricing services and brokers to ensure prices received represent a reasonable estimate of fair value and to confirm representations regarding whether inputs are observable or unobservable. Procedures include (i) the review of pricing service or broker pricing methodologies, (ii) back-testing, where past fair value estimates are compared to actual transactions executed in the market on similar dates, (iii) exception reporting, where changes in price, period-over-period, are reviewed and challenged with the pricing service or broker based on exception criteria, (iv) detailed analysis, where the Company independently validates information regarding inputs and assumptions for individual securities and (v) pricing validation, where prices received are compared to prices independently estimated by the Company.

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The fair values of CNA s life settlement contracts are included in Other assets on the Consolidated Condensed Balance Sheets. Equity options purchased are included in Equity securities, and all other derivative assets are included in Receivables. Derivative liabilities are included in Payable to brokers. Assets and liabilities measured at fair value on a recurring basis are summarized in the tables below:

June 30, 2013	Level 1	Level 2	Level 3	Total
(In millions)				
Fixed maturity securities:				
Corporate and other bonds	$ 30	$ 21,526	$ 202	$ 21,758
States, municipalities and political subdivisions		10,599	140	10,739
Asset-backed:				
Residential mortgage-backed		4,668	428	5,096
Commercial mortgage-backed		1,844	165	2,009
Other asset-backed		560	387	947
Total asset-backed		7,072	980	8,052
U.S. Treasury and obligations of government-sponsored enterprises	147	29		176
Foreign government	98	446		544
Redeemable preferred stock	49	58	25	132
Fixed maturities available-for-sale	324	39,730	1,347	41,401
Fixed maturities, trading	47	60	87	194
Total fixed maturities	$ 371	$ 39,790	$ 1,434	$ 41,595
Equity securities available-for-sale	$ 134	$ 52	$ 13	$ 199
Equity securities, trading	655		2	657
Total equity securities	$ 789	$ 52	$ 15	$ 856
Short term investments	$ 5,617	$ 423		$ 6,040
Other invested assets		36		36
Receivables		29	$ 8	37
Life settlement contracts			91	91
Separate account business	6	239	2	247
Payable to brokers	(135)	(16)	(3)	(154)

December 31, 2012	Level 1	Level 2	Level 3	Total
(In millions)				
Fixed maturity securities:				
Corporate and other bonds	$ 6	$ 21,982	$ 219	$ 22,207
States, municipalities and political subdivisions		10,687	96	10,783
Asset-backed:				
Residential mortgage-backed		5,507	413	5,920
Commercial mortgage-backed		1,693	129	1,822
Other asset-backed		584	368	952
Total asset-backed		7,784	910	8,694
U.S. Treasury and obligations of government-sponsored enterprises	158	24		182
Foreign government	140	473		613
Redeemable preferred stock	40	59	26	125
Fixed maturities available-for-sale	344	41,009	1,251	42,604
Fixed maturities, trading		72	89	161
Total fixed maturities	$ 344	$ 41,081	$ 1,340	$ 42,765
Equity securities available-for-sale	$ 117	$ 98	$ 34	$ 249
Equity securities, trading	642		7	649
Total equity securities	$ 759	$ 98	$ 41	$ 898
Short term investments	$ 4,990	$ 799	$ 6	$ 5,795
Other invested assets		58	1	59
Receivables		32	11	43
Life settlement contracts			100	100
Separate account business	4	306	2	312
Payable to brokers	(95)	(11)	(6)	(112)

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The tables below present reconciliations for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2013 and 2012:

		Net Realized Gains (Losses) and Net Change in Unrealized Gains (Losses)								Unrealized Gains (Losses) Recognized in Net Income on Level 3 Assets and Liabilities Held at
2013	Balance, April 1	Included in Net Income	Included in OCI	Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance, June 30	June 30
(In millions)										
Fixed maturity securities:										
Corporate and other bonds	$ 283	$ 1	$ (3)	$ 13	$ (54)	$ (6)		$ (32)	$ 202	$ (1)
States, municipalities and political subdivisions	129		4	37	(32)	(3)	$ 5		140	
Asset-backed:										
Residential mortgage-backed	450	(1)	(1)	50	(10)	(21)	4	(43)	428	(2)
Commercial mortgage-backed	177		4	5		(2)	21	(40)	165	
Other asset-backed	396		(3)	38	(33)	(11)			387	(1)
Total asset-backed	1,023	(1)	-	93	(43)	(34)	25	(83)	980	(3)
Redeemable preferred stock	26		(1)						25	
Fixed maturities available-for-sale	1,461	-	-	143	(129)	(43)	30	(115)	1,347	(4)
Fixed maturities, trading	107				(20)				87	
Total fixed maturities	$ 1,568	$ -	$ -	$ 143	$ (149)	$ (43)	$ 30	$ (115)	$ 1,434	$ (4)
Equity securities available-for-sale	$ 19	$ (5)	$ (1)						$ 13	$ (5)
Equity securities trading	3	(1)							2	(2)
Total equity securities	$ 22	$ (6)	$ (1)	$ -	$ -	$ -	$ -	$ -	$ 15	$ (7)

Short term investments	**$ 5**				**$ (5)**			**$ -**	
Life settlement contracts	**95**	**$ 4**				**$ (8)**		**91**	**$ (1)**
Separate account business	**2**							**2**	
Derivative financial instruments, net	**2**	**2**	**$ 2**	**$ 1**	**(1)**	**(1)**		**5**	

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2012	Balance, April 1	Net Realized Gains (Losses) and Net Change in Unrealized Gains (Losses) Included in Net Income	Included in OCI	Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance, June 30	Unrealized Gains (Losses) Recognized in Net Income on Level 3 Assets and Liabilities Held at June 30
(In millions)										
Fixed maturity securities:										
Corporate and other bonds	$ 485	$ 3	$ 2	$ 68	$ (26)	$ (13)	$ 9	$ (40)	$ 488	
States, municipalities and political subdivisions	173		1			(85)			89	
Asset-backed:										
Residential mortgage-backed	447	1	(18)	22		(9)			443	
Commercial mortgage-backed	105	2	4	87	(12)	(4)		(16)	166	
Other asset-backed	384	2	(1)	182	(99)	(34)			434	
Total asset-backed	936	5	(15)	291	(111)	(47)	-	(16)	1,043	
Redeemable preferred stock	53				(26)				27	
Fixed maturities available-for-sale	1,647	8	(12)	359	(163)	(145)	9	(56)	1,647	
Fixed maturities, trading	101				(3)			(4)	94	
Total fixed maturities	$ 1,748	$ 8	$ (12)	$ 359	$ (166)	$ (145)	$ 9	$ (60)	$ 1,741	$ -
Equity securities available-for-sale	$ 74		$ 19	$ 15	$ (15)				$ 93	$ (1)
Equity securities trading	11	$ (2)							9	(2)
Total equity securities	$ 85	$ (2)	$ 19	$ 15	$ (15)	$ -	$ -	$ -	$ 102	$ (3)
Short term investments	$ -			$ 4					$ 4	
Other invested assets	11								11	

Life settlement contracts	115	$ 20			$ (19)	116	$ 3
Separate account business	4			$ (1)		3	
Derivative financial instruments, net	(8)	1	$ 21	(1)	(1)	12	

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2013	Balance, January 1	Net Realized Gains (Losses) and Net Change in Unrealized Gains (Losses) Included in Net Income	Net Realized Gains (Losses) and Net Change in Unrealized Gains (Losses) Included in OCI	Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance, June 30	Unrealized Gains (Losses) Recognized in Net Income on Level 3 Assets and Liabilities Held at June 30
(In millions)										
Fixed maturity securities:										
Corporate and other bonds	$ 219	$ 1	$ (1)	$ 104	$ (71)	$ (26)	$ 26	$ (50)	$ 202	$ (2)
States, municipalities and political subdivisions	96	(3)	4	122	(79)	(5)	5		140	
Asset-backed:										
Residential mortgage-backed	413	2	(1)	111	(10)	(32)	4	(59)	428	(2)
Commercial mortgage-backed	129	1	9	78		(9)	21	(64)	165	
Other asset-backed	368	3	(2)	174	(132)	(24)			387	(1)
Total asset-backed	910	6	6	363	(142)	(65)	25	(123)	980	(3)
Redeemable preferred stock	26		(1)						25	
Fixed maturities available-for-sale	1,251	4	8	589	(292)	(96)	56	(173)	1,347	$ (5)
Fixed maturities, trading	89	1		19	(22)				87	1
Total fixed maturities	$ 1,340	$ 5	$ 8	$ 608	$ (314)	$ (96)	$ 56	$ (173)	$ 1,434	$ (4)
Equity securities available-for-sale	$ 34	$ (20)						$ (1)	$ 13	$ (20)
Equity securities trading	7	(5)							2	(5)
Total equity securities	$ 41	$ (25)	$ -	$ -	$ -	$ -	$ -	$ (1)	$ 15	$ (25)
Short term investments	$ 6				$ (6)				$ -	
Other invested assets	1				(1)				-	

Life settlement contracts	**100**	**$ 11**			**$ (20)**	**91**	**$ 1**
Separate account business	**2**					**2**	
Derivative financial instruments, net	**5**	**5**	**$ (2)**	**$ 1**	**(4)**	**5**	**1**

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2012	Balance, January 1	Net Realized Gains (Losses) and Net Change in Unrealized Gains (Losses) Included in Net Income	Included in OCI	Purchases	Sales	Settlements	Transfers into Level 3	Transfers out of Level 3	Balance, June 30	Unrealized Gains (Losses) Recognized in Net Income on Level 3 Assets and Liabilities Held at June 30
(In millions)										
Fixed maturity securities:										
Corporate and other bonds	$ 482	$ 6	$ 6	$ 146	$ (112)	$ (32)	$ 42	$ (50)	$ 488	
States, municipalities and political subdivisions	171		3			(85)			89	
Asset-backed:										
Residential mortgage-backed	452									

Current liabilities:					
Accounts payable	$—	$15,847	$908	$—	$16,755
Accrued interest	5,687	(1)	—	—	5,686
Deferred revenue	—	7,048	810	—	7,858
Accrued property taxes	—	3,522	2,014	—	5,536
Current maturities of operating leases	—	4,955	65	—	5,020
Current maturities of finance leases	—	877	—	—	877
Other current liabilities	192	2,459	5	—	2,656
Total current liabilities	5,879	34,707	3,802	—	44,388

Long-term debt	1,438,054	—	—	—	1,438,054
Noncurrent operating lease liabilities	—	72,269	—	—	72,269
Other long-term liabilities	260	12,716	386	—	13,362
Deferred revenue	—	48,131	—	—	48,131
Class B unit	—	46,941	—	—	46,941
Equity - partners	412,117	1,847,226	260,874	(2,108,100)	412,117
Equity - noncontrolling interest	—	—	86,958	—	86,958
Total liabilities and equity	$1,856,310	$2,061,990	$352,020	$(2,108,100)	$2,162,220

Condensed Consolidating Balance Sheet

December 31, 2018	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
ASSETS					
Current assets:					
Cash and cash equivalents	$2	$—	$ 3,043	$—	$ 3,045
Accounts receivable	—	53,376	5,994	(252)	59,118
Prepaid and other current assets	217	3,542	552	—	4,311
Total current assets	219	56,918	9,589	(252)	66,474
Properties and equipment, net	—	1,193,181	345,474	—	1,538,655
Investment in subsidiaries	1,850,416	264,378	—	(2,114,794)	—
Intangible assets, net	—	115,329	—	—	115,329
Goodwill	—	270,336	—	—	270,336
Equity method investments	—	83,840	—	—	83,840
Other assets	9,291	18,615	—	—	27,906
Total assets	$1,859,926	$ 2,002,597	$ 355,063	$(2,115,046)	$ 2,102,540
LIABILITIES AND EQUITY					
Current liabilities:					
Accounts payable	$—	$ 30,325	$ 584	$(252)	$ 30,657
Accrued interest	13,302	—	—	—	13,302
Deferred revenue	—	8,065	632	—	8,697
Accrued property taxes	—	744	1,035	—	1,779
Other current liabilities	29	3,429	4	—	3,462
Total current liabilities	13,331	42,563	2,255	(252)	57,897
Long-term debt	1,418,900	—	—	—	1,418,900
Other long-term liabilities	260	14,743	304	—	15,307
Deferred revenue	—	48,714	—	—	48,714
Class B unit	—	46,161	—	—	46,161
Equity - partners	427,435	1,850,416	264,378	(2,114,794)	427,435
Equity - noncontrolling interest	—	—	88,126	—	88,126
Total liabilities and equity	$1,859,926	$ 2,002,597	$ 355,063	$(2,115,046)	$ 2,102,540

Condensed Consolidating Statement of Income

Three Months Ended March 31, 2019	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	$—	$ 97,393	$ 5,966	$ —	$ 103,359
Third parties	—	22,065	9,073	—	31,138
	—	119,458	15,039	—	134,497
Operating costs and expenses:					
Operations (exclusive of depreciation and amortization)	—	34,077	3,442	—	37,519
Depreciation and amortization		19,536	4,288	—	23,824
General and administrative	1,076	1,544	—	—	2,620
	1,076	55,157	7,730	—	63,963
Operating income (loss)	(1,076)	64,301	7,309	—	70,534
Other income (expense):					
Equity in earnings of subsidiaries	71,299	5,496	—	(76,795)	—
Equity in earnings of equity method investments	—	2,100	—	—	2,100
Interest expense	(19,041)	19	—	—	(19,022)
Interest income	—	528	—	—	528
Gain on sale of assets and other	—	(329)	19	—	(310)
	52,258	7,814	19	(76,795)	(16,704)
Income before income taxes	51,182	72,115	7,328	(76,795)	53,830
State income tax expense	—	(36)	—	—	(36)
Net income	51,182	72,079	7,328	(76,795)	53,794
Allocation of net income attributable to noncontrolling interests	—	(780)	(1,832)	—	(2,612)
Net income attributable to the partners	$51,182	$ 71,299	$ 5,496	$ (76,795)	$ 51,182

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Condensed Consolidating Statement of Income

Three Months Ended March 31, 2018	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	$—	$ 94,291	$ 7,137	$ —	$ 101,428
Third parties	—	19,978	7,478	—	27,456
	—	114,269	14,615	—	128,884
Operating costs and expenses:					
Operations (exclusive of depreciation and amortization)	—	32,664	3,538	—	36,202
Depreciation and amortization	—	21,001	4,141	—	25,142
General and administrative	1,280	1,842	—	—	3,122
	1,280	55,507	7,679	—	64,466
Operating income (loss)	(1,280)	58,762	6,936	—	64,418
Other income (expense):					
Equity in earnings of subsidiaries	65,052	5,212	—	(70,264)	—
Equity in earnings of equity method investments	—	1,279	—	—	1,279
Interest expense	(17,649)	68	—	—	(17,581)
Interest income	—	515	—	—	515
Gain on sale of assets and other	45	28	13	—	86
	47,448	7,102	13	(70,264)	(15,701)
Income before income taxes	46,168	65,864	6,949	(70,264)	48,717
State income tax expense	—	(82)	—	—	(82)
Net income	46,168	65,782	6,949	(70,264)	48,635
Allocation of net income attributable to noncontrolling interests	—	(730)	(1,737)	—	(2,467)
Net income attributable to the partners	$46,168	$ 65,052	$ 5,212	$ (70,264)	$ 46,168

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Condensed Consolidating Statement of Cash Flows

Three Months Ended March 31, 2019	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Cash flows from operating activities	$(26,584)	$ 91,226	$ 12,009	$ (5,496)	$ 71,155
Cash flows from investing activities					
Additions to properties and equipment	—	(10,564)	(154)	—	(10,718)
Distributions from UNEV in excess of earnings	—	3,504	—	(3,504)	—
Proceeds from sale of assets	—	9	—	—	9
Distributions in excess of equity in earnings of equity investments	—	395	—	—	395
	—	(6,656)	(154)	(3,504)	(10,314)
Cash flows from financing activities					
Net borrowings under credit agreement	19,000	—	—	—	19,000
Net intercompany financing activities	75,678	(75,678)	—	—	—
Distributions to HEP unitholders	(67,975)	—	—	—	(67,975)
Distributions to noncontrolling interests	—	—	(12,000)	9,000	(3,000)
Units withheld for tax withholding obligations	(119)	—	—	—	(119)
Payments on finance leases	—	(252)	—	—	(252)
	26,584	(75,930)	(12,000)	9,000	(52,346)
Cash and cash equivalents					
Increase (decrease) for the period	—	8,640	(145)	—	8,495
Beginning of period	2	—	3,043	—	3,045
End of period	$2	$ 8,640	$ 2,898	$ —	$ 11,540

Condensed Consolidating Statement of Cash Flows

Three Months Ended March 31, 2018	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Cash flows from operating activities	$(23,679)	$ 98,013	$ 11,398	$ (5,212)	$ 80,520
Cash flows from investing activities					
Additions to properties and equipment	—	(9,029)	(3,583)	—	(12,612)
Proceeds from sale of assets	—	22	—	—	22
Distributions from UNEV in excess of earnings	—	788	—	(788)	—
Distributions in excess of equity in earnings of equity investments	—	358	—	—	358
	—	(7,861)	(3,583)	(788)	(12,232)
Cash flows from financing activities					
Net repayments under credit agreement	(116,500)	—	—	—	(116,500)
Net intercompany financing activities	89,060	(89,060)	—	—	—
Proceeds from issuance of common units	114,376	153	—	—	114,529
Distributions to HEP unitholders	(63,496)	—	—	—	(63,496)
Distributions to noncontrolling interests	—	—	(8,000)	6,000	(2,000)
Contributions from general partner	297	—	—	—	297
Units withheld for tax withholding obligations	(58)	—	—	—	(58)
Deferred financing costs	—	6	—	—	6
Payments on finance leases	—	(277)	—	—	(277)
	23,679	(89,178)	(8,000)	6,000	(67,499)
Cash and cash equivalents					
Increase (decrease) for the period	—	974	(185)	—	789
Beginning of period	2	511	7,263	—	7,776
End of period	$2	$ 1,485	$ 7,078	$ —	$ 8,565

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

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

OVERVIEW

HEP is a Delaware limited partnership. We own and operate petroleum product and crude oil pipelines, terminal, tankage and loading rack facilities and refinery processing units that support the refining and marketing operations of HollyFrontier Corporation (“HFC”) in the Mid-Continent, Southwest and Northwest regions of the United States and Delek US Holdings, Inc.’s (“Delek”) refinery in Big Spring, Texas. HEP, through its subsidiaries and joint ventures, owns and/or operates petroleum product and crude pipelines, tankage and terminals in Texas, New Mexico, Washington, Idaho, Oklahoma, Utah, Nevada, Wyoming and Kansas as well as refinery processing units in Utah and Kansas. HFC owned 57% of our outstanding common units and the non-economic general partnership interest, as of March 31, 2019.

We generate revenues by charging tariffs for transporting petroleum products and crude oil through our pipelines, by charging fees for terminalling and storing refined products and other hydrocarbons, providing other services at our storage tanks and terminals and charging a tolling fee per barrel or thousand standard cubic feet of feedstock throughput in our refinery processing units. We do not take ownership of products that we transport, terminal, store or process, and therefore, we are not directly exposed to changes in commodity prices.

We believe the long-term growth of global refined product demand and U.S. crude production should support high utilization rates for the refineries we serve, which in turn should support volumes in our product pipelines, crude gathering systems and terminals.

Agreements with HFC and Delek
We serve HFC’s refineries under long-term pipeline, terminal, tankage and refinery processing unit throughput agreements expiring from 2019 to 2036. Under these agreements, HFC agrees to transport, store and process throughput volumes of refined product, crude oil and feedstocks on our pipelines, terminal, tankage, and loading rack facilities and refinery processing units that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual rate adjustments on July 1st each year, based on the Producer Price Index (“PPI”) or Federal Energy Regulatory Commission index. As of March 31, 2019, these agreements with HFC require minimum annualized payments to us of $303 million.

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

We have a pipelines and terminals agreement with Delek expiring in 2020 under which Delek has agreed to transport on our pipelines and throughput through our terminals volumes of refined products that result in a minimum level of annual revenue that is also subject to annual tariff rate adjustments. We also have a capacity lease agreement under which we lease Delek space on our Orla to El Paso pipeline for the shipment of refined product. The terms for a

portion of the capacity under this lease agreement expired in 2018 and were not renewed, and the remaining portions of the capacity expire in 2020 and 2022. As of March 31, 2019, these agreements with Delek require minimum annualized payments to us of $32 million.

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

Under certain provisions of an omnibus agreement we have with HFC (the “Omnibus Agreement”), we pay HFC an annual administrative fee, currently $2.5 million, for the provision by HFC or its affiliates of various general and administrative services to us. This fee does not include the salaries of personnel employed by HFC who perform services for us on behalf of Holly Logistic Services, L.L.C. (“HLS”), or the cost of their employee benefits, which are separately charged to us by HFC. We also reimburse HFC and its affiliates for direct expenses they incur on our behalf.

Under HLS’s Secondment Agreement with HFC, certain employees of HFC are seconded to HLS to provide operational and maintenance services for certain of our processing, refining, pipeline and tankage assets, and HLS reimburses HFC for its prorated portion of the wages, benefits, and other costs of these employees for our benefit.

We have a long-term strategic relationship with HFC. Our current growth plan is to continue to pursue purchases of logistic and other assets at HFC's existing refining locations in New Mexico, Utah, Oklahoma, Kansas and Wyoming. We also expect to work with HFC on logistic asset acquisitions in conjunction with HFC's refinery acquisition strategies. Furthermore, we plan to continue to pursue third-party logistic asset acquisitions that are accretive to our unitholders and increase the diversity of our revenues.

RESULTS OF OPERATIONS (Unaudited)

Income, Distributable Cash Flow, Volumes and Balance Sheet Data The following tables present income, distributable cash flow and volume information for the three months ended March 31, 2019 and 2018.

	Three Months Ended March 31,		Change from
	2019	2018	2018
	(In thousands, except per unit data)		
Revenues:			
Pipelines:			
Affiliates—refined product pipelines	$20,732	$21,294	$(562)
Affiliates—intermediate pipelines	7,281	8,469	(1,188)
Affiliates—crude pipelines	21,121	19,797	1,324
	49,134	49,560	(426)
Third parties—refined product pipelines	15,604	13,582	2,022
Third parties—crude pipelines	10,362	9,027	1,335
	75,100	72,169	2,931
Terminals, tanks and loading racks:			
Affiliates	32,406	33,334	(928)
Third parties	5,172	4,847	325
	37,578	38,181	(603)
Affiliates—refinery processing units	21,819	18,534	3,285
Total revenues	134,497	128,884	5,613
Operating costs and expenses:			
Operations (exclusive of depreciation and amortization)	37,519	36,202	1,317
Depreciation and amortization	23,824	25,142	(1,318)
General and administrative	2,620	3,122	(502)
	63,963	64,466	(503)
Operating income	70,534	64,418	6,116
Other income (expense):			
Equity in earnings of equity method investments	2,100	1,279	821
Interest expense, including amortization	(19,022)	(17,581)	(1,441)
Interest income	528	515	13
Gain on sale of assets and other	(310)	86	(396)
	(16,704)	(15,701)	(1,003)
Income before income taxes	53,830	48,717	5,113
State income tax expense	(36)	(82)	46
Net income	53,794	48,635	5,159
Allocation of net income attributable to noncontrolling interests	(2,612)	(2,467)	(145)
Net income attributable to the partners	$51,182	$46,168	$5,014
Limited partners' earnings per unit—basic and diluted	$0.49	$0.44	$0.05
Weighted average limited partners' units outstanding	105,440	103,836	1,604
EBITDA (1)	$93,536	$88,458	$5,078
Distributable cash flow (2)	$70,599	$69,099	$1,500

Volumes (bpd)

Pipelines:			
Affiliates—refined product pipelines	130,807	144,805	(13,998)
Affiliates—intermediate pipelines	130,830	126,993	3,837
Affiliates—crude pipelines	400,797	360,409	40,388
	662,434	632,207	30,227
Third parties—refined product pipelines	81,064	72,239	8,825
Third parties—crude pipelines	126,496	126,014	482
	869,994	830,460	39,534
Terminals and loading racks:			
Affiliates	373,912	390,481	(16,569)
Third parties	68,765	62,352	6,413
	442,677	452,833	(10,156)
Affiliates—refinery processing units	65,837	66,875	(1,038)
Total for pipelines and terminal and refinery processing unit assets (bpd)	1,378,508	1,350,168	28,340

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

	Three Months Ended March 31,	
	2019	2018
	(In thousands)	
Net income attributable to the partners	$51,182	$46,168
Add (subtract):		
Interest expense	18,256	16,824
Interest income	(528)	(515)
Amortization of discount and deferred debt issuance costs	766	757
State income tax expense	36	82
Depreciation and amortization	23,824	25,142
EBITDA	$93,536	$88,458

(2) Distributable cash flow is not a calculation based upon GAAP. However, the amounts included in the calculation are derived from amounts presented in our consolidated financial statements, with the general exceptions of maintenance capital expenditures. Distributable cash flow should not be considered in isolation or as an alternative to net income or operating income as an indication of our operating performance or as an alternative to operating cash flow as a measure of liquidity. Distributable cash flow is not necessarily comparable to similarly titled measures of other companies. Distributable cash flow is presented here because it is a widely accepted financial indicator used by investors to compare partnership performance. It is also used by management for internal analysis and for our performance units. We believe that this measure provides investors an enhanced perspective of the operating performance of our assets and the cash our business is generating. Set forth below is our calculation of distributable cash flow.

	Three Months Ended March 31,	
	2019	2018
	(In thousands)	
Net income attributable to the partners	$51,182	$46,168
Add (subtract):		
Depreciation and amortization	23,824	25,142
Amortization of discount and deferred debt issuance costs	766	757
Revenue recognized greater than customer billings	(3,034)	(1,681)
Maintenance capital expenditures [3]	(735)	(318)
Decrease in environmental liability	(278)	(140)
Decrease in reimbursable deferred revenue	(1,579)	(1,177)

Other non-cash adjustments	453	348
Distributable cash flow	$70,599	$69,099

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

	March 31, 2019	December 31, 2018
	(In thousands)	
Balance Sheet Data		
Cash and cash equivalents	$11,540	$ 3,045
Working capital	$21,841	$ 8,577
Total assets	$2,162,220	$ 2,102,540
Long-term debt	$1,438,054	$ 1,418,900
Partners' equity[4]	$412,117	$ 427,435

(4) As a master limited partnership, we distribute our available cash, which historically has exceeded our net income attributable to the partners because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in partners' equity since our regular quarterly distributions have exceeded our quarterly net income attributable to the partners. Additionally, if the assets contributed and acquired from HFC while we were a consolidated variable interest entity of HFC had been acquired from third parties, our acquisition cost in excess of HFC's basis in the transferred assets would have been recorded in our financial statements as increases to our properties and equipment and intangible assets at the time of acquisition instead of decreases to partners' equity.

Results of Operations—Three Months Ended March 31, 2019 Compared with Three Months Ended March 31, 2018

Summary

Net income attributable to the partners for the first quarter was $51.2 million ($0.49 per basic and diluted limited partner unit) compared to $46.2 million ($0.44 per basic and diluted limited partner unit) for the first quarter of 2018. The increase in net income attributable to the partners was mainly due to higher crude oil pipeline volumes around the Permian Basin, higher revenues on our refinery processing units, and contractual tariff escalators. These gains were partially offset by higher interest expense.

Revenues

Revenues for the quarter were $134.5 million, an increase of $5.6 million compared to the first quarter of 2018. The increase was mainly attributable to higher crude oil pipeline volumes around the Permian Basin in New Mexico and Texas, which contributed to an increase in overall pipeline volumes of 5%, higher revenues on our refinery processing units and contractual tariff escalators.

Revenues from our refined product pipelines were $36.3 million, an increase of $1.5 million, on shipments averaging 211.9 thousand barrels per day ("mbpd") compared to 217.0 mbpd for the first quarter of 2018. The volume decrease was mainly due to pipelines servicing HFC's Woods Cross refinery, which had lower throughput due to operational issues at the refinery during the quarter partially offset by higher volumes from Delek. The increase in revenues was mainly due to higher Delek volumes and contractual tariff escalators.

Revenues from our intermediate pipelines were $7.3 million, a decrease of $1.2 million compared to the first quarter of 2018, on shipments averaging 130.8 mbpd compared to 127.0 mbpd for the first quarter of 2018. The decrease in revenue was primarily attributable to a decrease in deferred revenue realized.

Revenues from our crude pipelines were $31.5 million, an increase of $2.7 million, on shipments averaging 527.3 mbpd compared to 486.4 mbpd for the first quarter of 2018. The increases were mainly attributable to increased volumes on our crude pipeline systems in New Mexico and Texas and on our crude pipeline systems in Wyoming and Utah.

Revenues from terminal, tankage and loading rack fees were $37.6 million, a decrease of $0.6 million compared to the first quarter of 2018. Refined products and crude oil terminalled in the facilities averaged 442.7 mbpd compared to 452.8 mbpd for the first quarter of 2018. The volume decrease and associated revenue decrease were mainly due to the planned turnaround at HFC's Tulsa refinery and operational issues at HFC's El Dorado refinery in the first quarter of 2019.

Revenues from refinery processing units were $21.8 million, an increase of $3.3 million compared to the first quarter of 2018, on throughputs averaging 65.8 mbpd compared to 66.9 mbpd for the first quarter of 2018. The increase in revenue was mainly due to an adjustment in revenue recognition and contractual rate increases.

Operations Expense
Operations (exclusive of depreciation and amortization) expense was $37.5 million for the three months ended March 31, 2019, an increase of $1.3 million compared to the first quarter of 2018. The increase was mainly due to higher property taxes and employee compensation expenses for the three months ended March 31, 2018.

Depreciation and Amortization
Depreciation and amortization for the three months ended March 31, 2019, decreased by $1.3 million compared to the three months ended March 31, 2018. The decrease was mainly due to lower amortization of intangible assets and asset retirement obligations.

General and Administrative
General and administrative costs for the three months ended March 31, 2019, decreased by $0.5 million compared to the three months ended March 31, 2018, mainly due to higher legal and consulting costs incurred in the three months ended March 31, 2018.

Equity in Earnings of Equity Method Investments

	Three Months Ended March 31,	
Equity Method Investment	2019	2018
	(in thousands)	
Osage Pipe Line Company, LLC	$505	$642
Cheyenne Pipeline LLC	1,595	637
Total	$2,100	$1,279

Equity in earnings of Cheyenne Pipeline LLC were higher for the three months ended March 31, 2019, mainly due to higher crude throughput volumes.

Interest Expense
Interest expense for the three months ended March 31, 2019, totaled $19.0 million, an increase of $1.4 million compared to the three months ended March 31, 2018. The increase is primarily due to interest expense associated with higher average balances outstanding under the Credit Agreement (as defined below) and market interest rate increases under that facility. Our aggregate effective interest rates were 5.3% and 4.9% for the three months ended March 31, 2019 and 2018, respectively.

State Income Tax
We recorded state income tax expense of $36,000 and $82,000 for the three months ended March 31, 2019 and 2018, respectively. All tax expense is solely attributable to the Texas margin tax.

LIQUIDITY AND CAPITAL RESOURCES

Overview
We have a $1.4 billion senior secured revolving credit facility (the “Credit Agreement”) expiring in July 2022. The Credit Agreement is available to fund capital expenditures, investments, acquisitions, distribution payments and

working capital and for general partnership purposes. The Credit Agreement is also available to fund letters of credit up to a $50 million sub-limit, and it contains an accordion feature giving us the ability to increase the size of the facility by up to $300 million with additional lender commitments.

During the three months ended March 31, 2019, we received advances totaling $104.0 million and repaid $85.0 million, resulting in a net increase of $19.0 million under the Credit Agreement and an outstanding balance of $942.0 million at March 31, 2019. As of March 31, 2019, we have no letters of credit outstanding under the Credit Agreement and the available capacity under the Credit Agreement was $458.0 million. Amounts repaid under the Credit Agreement may be reborrowed from time to time.

If any particular lender under the Credit Agreement could not honor its commitment, we believe the unused capacity that would be available from the remaining lenders would be sufficient to meet our borrowing needs. Additionally, we review publicly available information on the lenders in order to monitor their financial stability and assess their ongoing ability to honor their

commitments under the Credit Agreement. We do not expect to experience any difficulty in the lenders' ability to honor their respective commitments, and if it were to become necessary, we believe there would be alternative lenders or options available.

On January 25, 2018, we entered into a common unit purchase agreement in which certain purchasers agreed to purchase in a private placement 3,700,000 common units representing limited partnership interests, at a price of $29.73 per common unit. The private placement closed on February 6, 2018, and we received proceeds of approximately $110 million, which were used to repay indebtedness under the Credit Agreement.

We have a continuous offering program under which we may issue and sell common units from time to time, representing limited partner interests, up to an aggregate gross sales amount of $200 million. We did not issue any units under this program during the three months ended March 31, 2019. We intend to use the net proceeds for general partnership purposes, which may include funding working capital, repayment of debt, acquisitions and capital expenditures. As of March 31, 2019, HEP has issued 2,413,153 units under this program, providing $82.3 million in gross proceeds.

Under our registration statement filed with the Securities and Exchange Commission ("SEC") using a "shelf" registration process, we currently have the authority to raise up to $2.0 billion, less amounts issued under the $200 million continuous offering program, by offering securities, through one or more prospectus supplements that would describe, among other things, the specific amounts, prices and terms of any securities offered and how the proceeds would be used. Any proceeds from the sale of securities would be used for general business purposes, which may include, among other things, funding acquisitions of assets or businesses, working capital, capital expenditures, investments in subsidiaries, the retirement of existing debt and/or the repurchase of common units or other securities.

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

In February 2019, we paid a regular cash distribution of $0.6675 on all units in an aggregate amount of $68.0 million after deducting HEP Logistics' waiver of $2.5 million of limited partner cash distributions.

Cash and cash equivalents increased by $8.5 million during the three months ended March 31, 2019. The cash flows provided by operating activities of $71.2 million were more than the cash flows used for financing activities of $52.3 million and investing activities of $10.3 million. Working capital increased by $13.3 million to $21.8 million at March 31, 2019, from $8.6 million at December 31, 2018.

Cash Flows—Operating Activities
Cash flows from operating activities decreased by $9.4 million from $80.5 million for the three months ended March 31, 2018, to $71.2 million for the three months ended March 31, 2019. The decrease was mainly due to higher payments for operating and interest expenses during the three months ended March 31, 2019, as compared to the three months ended March 31, 2018 partially offset by increased receipts from customers.

Cash Flows—Investing Activities
Cash flows used for investing activities were $10.3 million for the three months ended March 31, 2019, compared to $12.2 million for the three months ended March 31, 2018, a decrease of $1.9 million. During the three months ended March 31, 2019 and 2018, we invested $10.7 million and $12.6 million in additions to properties and equipment, respectively. We also received $0.4 million for distributions in excess of equity in earnings of equity investments during both the three months ended March 31, 2019 and 2018.

Cash Flows—Financing Activities

Cash flows used for financing activities were $52.3 million for the three months ended March 31, 2019, compared to $67.5 million for the three months ended March 31, 2018, a decrease of $15.2 million. During the three months ended March 31, 2019, we received $104.0 million and repaid $85.0 million in advances under the Credit Agreement. Additionally, we paid $68.0 million in regular quarterly cash distributions to our limited partners and $3.0 million to our noncontrolling interest. During the three months ended March 31, 2018, we received $227.0 million and repaid $343.5 million in advances under the Credit Agreement. We paid $63.5 million in regular quarterly cash distributions to our limited partners, and distributed $2.0 million to our noncontrolling interest. We also received net proceeds of $114.5 million from the issuance of common units.

Capital Requirements

Our pipeline and terminalling operations are capital intensive, requiring investments to maintain, expand, upgrade or enhance existing operations and to meet environmental and operational regulations. Our capital requirements have consisted of, and are expected to continue to consist of, maintenance capital expenditures and expansion capital expenditures. “Maintenance capital

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

Each year the board of directors of HLS, our ultimate general partner, approves our annual capital budget, which specifies capital projects that our management is authorized to undertake. Additionally, at times when conditions warrant or as new opportunities arise, additional projects may be approved. The funds allocated for a particular capital project may be expended over a period in excess of a year, depending on the time required to complete the project. Therefore, our planned capital expenditures for a given year consist of expenditures approved for capital projects included in the current year's capital budget as well as, in certain cases, expenditures approved for capital projects in capital budgets for prior years. The 2019 capital budget is comprised of approximately $10 million for maintenance capital expenditures and approximately $20 million to $25 million for expansion capital expenditures. We expect the majority of the expansion capital budget to be invested in refined product pipeline expansions, crude system enhancements, new storage tanks and enhanced blending capabilities at our racks. In addition to our capital budget, we may spend funds periodically to perform capital upgrades or additions to our assets where a customer reimburses us for such costs. The upgrades or additions would generally benefit the customer over the remaining life of the related service agreements.
We expect that our currently planned sustaining and maintenance capital expenditures, as well as expenditures for acquisitions and capital development projects, will be funded with cash generated by operations, the sale of additional limited partner common units, the issuance of debt securities and advances under our Credit Agreement, or a combination thereof. With volatility and uncertainty at times in the credit and equity markets, there may be limits on our ability to issue new debt or equity financing. Additionally, due to pricing movements in the debt and equity markets, we may not be able to issue new debt and equity securities at acceptable pricing. Without additional capital beyond amounts available under the Credit Agreement, our ability to obtain funds for some of these capital projects may be limited.

Under the terms of the transaction to acquire HFC's 75% interest in UNEV, we issued to HFC a Class B unit comprising a noncontrolling equity interest in a wholly-owned subsidiary subject to redemption to the extent that HFC is entitled to a 50% interest in our share of annual UNEV earnings before interest, income taxes, depreciation, and amortization above $30 million beginning July 1, 2015, and ending in June 2032, subject to certain limitations. However, to the extent earnings thresholds are not achieved, no redemption payments are required. No redemption payments have been required to date.

Credit Agreement
Our $1.4 billion Credit Agreement expires in July 2022. The Credit Agreement is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. The Credit Agreement is also available to fund letters of credit up to a $50 million sub-limit, and it contains an accordion feature giving us the ability to increase the size of the facility by up to $300 million with additional lender commitments.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets, and indebtedness under the Credit Agreement is guaranteed by our material, wholly-owned subsidiaries. The Credit Agreement requires us to maintain compliance with certain financial covenants consisting of total leverage, senior secured leverage, and interest coverage. It also limits or restricts our ability to engage in certain activities. If, at any time

prior to the expiration of the Credit Agreement, HEP obtains two investment grade credit ratings, the Credit Agreement will become unsecured and many of the covenants, limitations, and restrictions will be eliminated.

We may prepay all loans at any time without penalty, except for tranche breakage costs. If an event of default exists under the Credit Agreement, the lenders will be able to accelerate the maturity of all loans outstanding and exercise other rights and remedies. We were in compliance with all covenants as of March 31, 2019.

Senior Notes

We have $500 million in aggregate principal amount of 6% Senior Notes due in 2024 (the " 6% Senior Notes"). We used the net proceeds from our offerings of the 6% Senior Notes to repay indebtedness under our Credit Agreement.

The 6% Senior Notes are unsecured and impose certain restrictive covenants, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. We were in compliance with the restrictive covenants for the 6% Senior Notes as of March 31, 2019. At any time when the 6% Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default

exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights at varying premiums over face value under the 6% Senior Notes.

Indebtedness under the 6% Senior Notes is guaranteed by our wholly-owned subsidiaries.

Long-term Debt

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

	March 31, 2019	December 31, 2018
	(In thousands)	
Credit Agreement	$942,000	$923,000
6% Senior Notes		
Principal	500,000	500,000
Unamortized debt issuance costs	(3,946)	(4,100)
	496,054	495,900
Total long-term debt	$1,438,054	$1,418,900

Contractual Obligations

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

Impact of Inflation

Inflation in the United States has been relatively moderate in recent years and did not have a material impact on our results of operations for the three months ended March 31, 2019 and 2018. PPI has increased an average of 0.8% annually over the past five calendar years, including increases of 3.1% and 3.2% in 2018 and 2017, respectively.

The substantial majority of our revenues are generated under long-term contracts that provide for increases or decreases in our rates and minimum revenue guarantees annually for increases or decreases in the PPI. Certain of these contracts have provisions that limit the level of annual PPI percentage rate increases or decreases. A significant and prolonged period of high inflation or a significant and prolonged period of negative inflation could adversely affect our cash flows and results of operations if costs increase at a rate greater than the fees we charge our shippers.

Environmental Matters

Our operation of pipelines, terminals, and associated facilities in connection with the transportation and storage of refined products and crude oil is subject to stringent and complex federal, state, and local laws and regulations governing the discharge of materials into the environment, or otherwise relating to the protection of the environment. As with the industry generally, compliance with existing and anticipated laws and regulations increases our overall cost of business, including our capital costs to construct, maintain, and upgrade equipment and facilities. While these laws and regulations affect our maintenance capital expenditures and net income, we believe that they do not affect our competitive position given that the operations of our competitors are similarly affected. However, these laws and regulations, and the interpretation or enforcement thereof, are subject to frequent change by regulatory authorities, and we are unable to predict the ongoing cost to us of complying with these laws and regulations or the future impact of these laws and regulations on our operations. Violation of environmental laws, regulations, and permits can result in the imposition of significant administrative, civil and criminal penalties, injunctions, and construction bans or delays. A major discharge of hydrocarbons or hazardous substances into the environment could, to the extent the event is not insured, subject us to substantial expense, including both the cost to comply with applicable laws and regulations and claims made by employees, neighboring landowners and other third parties for personal injury and property damage.

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

We have an environmental agreement with Delek with respect to pre-closing environmental costs and liabilities relating to the pipelines and terminals acquired from Delek in 2005, under which Delek will indemnify us subject to certain monetary and time limitations.

There are environmental remediation projects in progress that relate to certain assets acquired from HFC. Certain of these projects were underway prior to our purchase and represent liabilities retained by HFC. At March 31, 2019, we had an accrual of $6.0 million that related to environmental clean-up projects for which we have assumed liability or for which the indemnity provided for by HFC has expired or will expire. The remaining projects, including assessment and monitoring activities, are covered under the HFC environmental indemnification discussed above and represent liabilities of HFC.

CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities as of the date of the financial statements. Actual results may differ from these estimates under different assumptions or conditions. Our significant accounting policies are described in “Item 7. Management’s Discussion and Analysis of Financial Condition and Operations—Critical Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2018. Certain critical accounting policies that materially affect the amounts recorded in our consolidated financial statements include revenue recognition, assessing the possible impairment of certain long-lived assets and goodwill, and assessing contingent liabilities for probable losses. With the exception of certain of our revenue recognition policies discussed in Note 2 of Notes to the Consolidated Financial Statements, there have been no changes to these policies in 2019. We consider these policies to be the most critical to understanding the judgments that are involved and the uncertainties that could impact our results of operations, financial condition and cash flows.

Accounting Pronouncements Adopted During the Periods Presented

Leases
In February 2016, ASU No. 2016-02, “Leases” (“ASC 842”) was issued requiring leases to be measured and recognized as a lease liability, with a corresponding right-of-use asset on the balance sheet. We adopted this standard effective January 1, 2019, and we elected to adopt using the modified retrospective transition method, whereby comparative prior period financial information will not be restated and will continue to be reported under the lease accounting standard in effect during those periods. We also elected practical expedients provided by the new standard, including the package of practical expedients and the short-term lease recognition practical expedient, which allows an entity to not recognize on the balance sheet leases with a term of 12 months or less. Upon adoption of this standard, we recognized $78.4 million of lease liabilities and corresponding right-of-use assets on our consolidated balance sheet. Adoption of the standard did not have a material impact on our results of operations or cash flows. See Notes 2 and 3 of Notes to the Consolidated Financial Statements for additional information on our lease policies.

Revenue Recognition
In May 2014, an accounting standard update 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 had an effective date of January 1, 2018, and we accounted for the new guidance using the modified retrospective implementation method, whereby a cumulative effect adjustment was recorded to retained earnings as of the date of initial application. In preparing for adoption, we evaluated the terms, conditions and performance obligations under our existing contracts with customers. Furthermore, we implemented policies to comply with this new standard. See Note 2 of Notes to the Consolidated Financial Statements for additional information on our revenue recognition policies.

Business Combinations

In December 2014, an accounting standard update was issued to provide new guidance on the definition of a business in relation to accounting for identifiable intangible assets in business combinations. This standard had an effective date of January 1, 2018, and had no effect on our financial condition, results of operations or cash flows.

Financial Assets and Liabilities

In January 2016, an accounting standard update was issued requiring changes in the accounting and disclosures for financial instruments. This standard was effective beginning with our 2018 reporting year and had no effect on our financial condition, results of operations or cash flows.

RISK MANAGEMENT

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

At March 31, 2019, we had an outstanding principal balance of $500 million on our 6% Senior Notes. A change in interest rates generally would affect the fair value of the 6% Senior Notes, but not our earnings or cash flows. At March 31, 2019, the fair value of our 6% Senior Notes was $517.7 million. We estimate a hypothetical 10% change in the yield-to-maturity applicable to the 6% Senior Notes at March 31, 2019, would result in a change of approximately $12 million in the fair value of the underlying 6% Senior Notes.

For the variable rate Credit Agreement, changes in interest rates would affect cash flows, but not the fair value. At March 31, 2019, borrowings outstanding under the Credit Agreement were $942.0 million. A hypothetical 10% change in interest rates applicable to the Credit Agreement would not materially affect our cash flows.

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

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

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk of loss arising from adverse changes in market rates and prices. See "Risk Management" under "Management's Discussion and Analysis of Financial Condition and Results of Operations" for a discussion of market risk exposures that we have with respect to our long-term debt, which disclosure should be read in conjunction with the quantitative and qualitative disclosures about market risk contained in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

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

Item 4. Controls and Procedures

(a) Evaluation of disclosure controls and procedures

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

effective as of March 31, 2019, at a reasonable level of assurance.

(b) Changes in internal control over financial reporting

During the three months ended March 31, 2019, we implemented a new lease accounting system and process in response to the adoption of ASC 842, effective January 1, 2019. Accordingly, we added additional controls over financial reporting to address the reporting requirements under ASC 842.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

In the ordinary course of business, we may become party to legal, regulatory or administrative proceedings or governmental investigations, including environmental and other matters. Damages or penalties may be sought from us in some matters and certain matters may require years to resolve. While the outcome and impact of these proceedings and investigations on us cannot be predicted with certainty, based on advice of counsel, management believes that the resolution of these proceedings and investigations, through settlement or adverse judgment, will not, either individually or in the aggregate, have a materially adverse effect on our financial condition, results of operations or cash flows.

Environmental Matters

We are reporting the following proceedings to comply with SEC regulations which require us to disclose proceedings arising under federal, state or local provisions regulating the discharge of materials into the environment or protecting the environment if we reasonably believe that such proceedings may result in monetary sanctions of $100,000 or more. Our respective subsidiaries have or will develop corrective action plans regarding the subject of these proceedings that will be implemented in consultation with the respective federal and state agencies. It is not possible to predict the ultimate outcome of these proceedings, although none are currently expected to have a material effect on our financial condition, results of operations or cash flows.

Written Safety Compliance Program

Holly Energy Partners - Operating, L.P. (“HEP Operating”) received a Notice of Probable Violation (NOPV) dated June 20, 2018 from the Pipeline and Hazardous Materials Safety Administration (“PHMSA”). The NOPV follows a routine inspection of HEP's facilities and records and is not in response to an incident. In the NOPV, PHMSA alleges certain regulatory violations involving HEP Operating’s written safety compliance program for its pipelines, terminals and tanks. PHMSA has proposed a civil penalty and a compliance order that would require HEP Operating to take certain remedial actions. HEP Operating is currently working with PHMSA to resolve this matter.

Other

We are a party to various other legal and regulatory proceedings, which we believe, based on the advice of counsel, will not either individually or in the aggregate have a materially adverse impact on our financial condition, results of operations or cash flows.

Item 1A. Risk Factors

There have been no material changes in our risk factors as previously disclosed in Part 1, “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018. In addition to the other information set forth in this quarterly report, you should consider carefully the factors discussed in our 2018 Form 10-K, which could materially affect our business, financial condition or future results. The risks described in our 2018 Form 10-K are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial may also materially and adversely affect our business, financial condition or future results.

Item 6. Exhibits

The Exhibit Index on page 41 of this Quarterly Report on Form 10-Q lists the exhibits that are filed or furnished, as applicable, as part of this Quarterly Report on Form 10-Q.

Exhibit Index

Exhibit Number	Description
3.1	Second Amended and Restated Agreement of Limited Partnership of Holly Energy Partners, L.P. (incorporated by reference to Exhibit 3.1 to Registrant's Current Report on Form 8-K filed on November 1, 2017, File No. 1-32225).
3.2	First Amended and Restated Agreement of Limited Partnership of Holly Energy Partners - Operating Company, L.P. (incorporated by reference to Exhibit 3.2 of Registrant's Quarterly Report on Form 10-Q for the quarterly period ended June 30, 2004, File No. 1-32225).
3.3	First Amended and Restated Agreement of Limited Partnership of HEP Logistics Holdings, L.P. (incorporated by reference to Exhibit 3.4 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.4	First Amended and Restated Limited Liability Company Agreement of Holly Logistic Services, L.L.C. (incorporated by reference to Exhibit 3.5 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
3.5	Amendment No. 1 to the First Amended and Restated Limited Liability Company Agreement of Holly Logistic Services, L.L.C., dated April 27, 2011 (incorporated by reference to Exhibit 3.1 of Registrant's Form 8-K Current Report filed on May 3, 2011, File No. 1-32225).
3.6	First Amended and Restated Limited Liability Company Agreement of HEP Logistics GP, L.L.C. (incorporated by reference to Exhibit 3.6 of Registrant's Quarterly Report on Form 10-Q for its quarterly period ended June 30, 2004, File No. 1-32225).
10.1*	First Amendment to Third Amended and Restated Crude Pipelines and Tankage Agreement, dated April 22, 2019, by and among HollyFrontier Navajo Refining LLC, HollyFrontier Woods Cross Refining LLC, HollyFrontier Refining & Marketing LLC, Holly Energy Partners - Operating, L.P., HEP Pipeline, L.L.C. and HEP Woods Cross, L.L.C.
31.1*	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002.
32.1**	Certification of Chief Executive Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
32.2**	Certification of Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002.
101+	The following financial information from Holly Energy Partners, L.P.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2019, formatted in XBRL (Extensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows, (v) Consolidated Statement of Partners' Equity, and (vi) Notes to Consolidated Financial Statements.

* Filed herewith.
** Furnished herewith.
\+ Filed electronically herewith.

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HOLLY ENERGY PARTNERS, L.P.
SIGNATURES

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

HOLLY ENERGY PARTNERS, L.P.
(Registrant)

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

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

Date: May 2, 2019	/s/ Richard L. Voliva III Richard L. Voliva III Executive Vice President and Chief Financial Officer (Principal Financial Officer)
Date: May 2, 2019	/s/ Kenneth P. Norwood Kenneth P. Norwood Vice President and Controller (Principal Accounting Officer)

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