HOLLY CORPORATION

1999 ANNUAL REPORT

HOLLY CORPORATION Navajo MONTANA

HOLLY CORPORATION THROUGH ITS AFFILIATES, NAVAJO REFINING COMPANY AND MONTANA REFINING COMPANY, IS ENGAGED IN THE REFINING, TRANSPORTATION, TERMINALLING AND MARKETING OF PETROLEUM PRODUCTS.

FINANCIAL AND OPERATING HIGHLIGHTS

Years ended July 31,	1999	1998	1997
Sales and other revenues	$ 597,986,000	$ 590,299,000	$ 721,346,000
Income before income taxes	$ 33,159,000	$ 24,866,000	$ 21,819,000
Net income	$ 19,937,000	$ 15,167,000	$ 13,087,000
Net income per common share (basic and diluted)	$ 2.42	$ 1.84	$ 1.59
Net cash provided by operating activities	$ 47,628,000	$ 38,193,000	$ 5,457,000
Capital expenditures	$ 26,903,000	$ 49,715,000	$ 30,304,000
Total assets	$ 390,982,000	$ 349,857,000	$ 349,803,000
Working capital	$ 13,851,000	$ 14,793,000	$ 45,241,000
Long-term debt (including current portion)	$ 70,341,000	$ 75,516,000	$ 86,291,000
Stockholders' equity	$ 128,880,000	$ 114,349,000	$ 105,121,000
Employees	614	588	572

CONTENTS

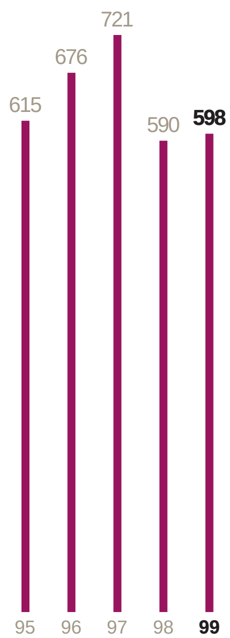
This Annual Report contains statements with respect to the Company's expectations or beliefs as to future events. These types of statements are "forward-looking" and are subject to uncertainties. See "Factors Affecting Forward-Looking Statements" on page 9.

TO OUR STOCKHOLDERS

The fiscal year just concluded marked another year of increased earnings and the highest such level since 1994. In conjunction with efforts to control outlays, cash flow increased sharply and your Company's financial condition strengthened.

Net income of the Company increased from $15.2 million in 1998 to $19.9 million in fiscal 1999. The

SALES AND OTHER REVENUES
(millions of dollars)



The Company's Navajo Refinery in Artesia, New Mexico converts approximately 90% of its raw materials into high value refined products and serves markets in the southwestern United States and northern Mexico.

increase in income was driven by increased profitability at the Navajo Refinery as well as increased contributions from our transportation business. Refining results benefited from strong margins during the latter part of the fiscal year and the full effects of process improvements implemented at the Navajo Refinery during 1998. Significant growth in transportation business activities provided increased earnings for this segment over the prior year.

The cornerstones for growth in our transportation business division have been an expansion of the Navajo Refinery's supply and distribution network together with development and participation in transportation ventures with other companies. Within the last three years, your Company has more than doubled its pipeline network from approximately 1,000 miles to 2,000 miles through a combination of lease and purchase transactions and new construction. We hope to continue growing this business over the next several years.

One of the major elements of growth in our transportation business has been the operation of a West Texas crude oil gathering system, which the Company acquired in 1998. This system provides transportation revenues as well as a source of supply for the Navajo Refinery.

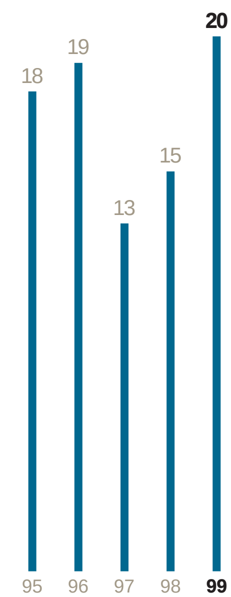
During 1997, we also formed an alliance between Navajo Refining Company and Fina, Inc., which has resulted in a gasoline and diesel supply network for the growing markets of West Texas, Arizona and New Mexico. Under this agreement, Fina utilizes a Company pipeline to transport refined products from its West Texas refinery to El Paso. Holly began realizing both pipeline and terminalling revenues under this arrangement during fiscal 1999.

During 1999, we completed construction of a 65-mile pipeline between Lovington and Artesia, New Mexico. Completion of this line allowed Navajo to provide transportation of LPGs for other companies as well as enhance its raw material supply capabilities.

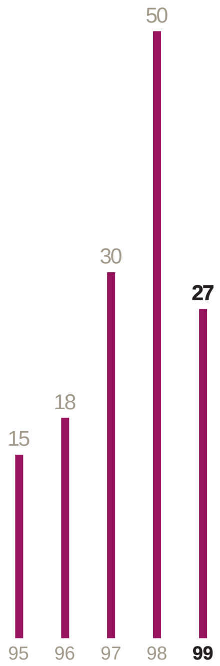
This year was another successful year for our Rio Grande Pipeline joint venture. This joint venture, in which we own a 25% interest with Mid-America Pipeline Company and BP Amoco, provides pipeline transportation of LPGs to Mexico. An expansion of this pipeline's capacity, currently under discussion, will provide the opportunity for further growth in earnings.

Unfortunately, the market price of Holly shares has not reflected this strong growth in our transportation business and our improved financial performance at the Navajo Refinery. While we don't profess to understand the

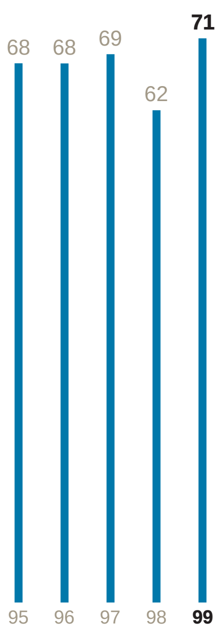
NET INCOME
(millions of dollars)
(includes accounting change)



CAPITAL EXPENDITURES
(millions of dollars)



REFINERY PRODUCTION
(thousand barrels per day)

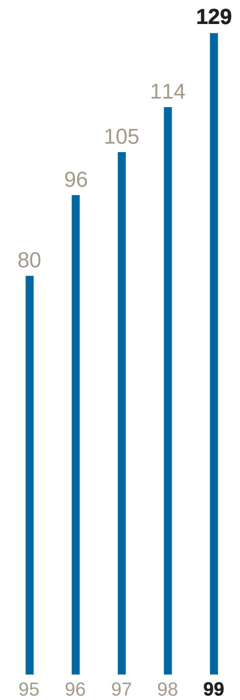


movement of markets, many observers relate the depressed share price to the continued existence of the Longhorn Partners Pipeline, L.P. lawsuit. As you may remember, this suit was filed against us in August 1998 and alleges damages in excess of one billion dollars. Preliminary procedures on this case consumed most of the last 12 months, and there is no timetable yet for final adjudication. In our judgment, this lawsuit has no merit whatsoever. In fact, we believe that the suit's lack of merit is more obvious after the preliminary results, just released, of a federal environmental assessment on the Longhorn Pipeline. The draft report concludes that the Longhorn Pipeline would have potential for significant adverse environmental impact unless a proposed 34-part remediation plan is carried out. While we remain sensitive to the decline in our share price and intend to pursue efforts to increase operating cash flow in the hopes of near-term improvement, we remain committed to a vigorous defense of the lawsuit and ultimate vindication for the Company.

Finally, there were some significant organizational changes during the year. Two of our most senior executives, Jack Reid, Executive Vice President, Refining, and Bill Gray, Senior Vice President, Marketing and Supply, have chosen to retire after many years of dedicated service. In light of these changes, Matt Clifton has assumed additional responsibilities as President of Navajo Refining Company. While Jack's and Bill's contributions will be sorely missed, they have both agreed to serve as consultants to the Company and to remain on the Board of Directors. On behalf of the Board of Directors, employees, suppliers,

The Company's Montana Refinery near Great Falls, Montana can process a wide range of crude oils and serves markets primarily in Montana.

STOCKHOLDERSÕ EQUITY
(millions of dollars)



customers and ourselves, we wish to thank Jack and Bill for their many years of service and significant contributions to the success of the Company.

We also had an increase in the membership of our Board this year. W. John Glancy, Senior Vice President, General Counsel and Secretary, was elected in September 1999. John has been associated with Holly in a variety of capacities over more than 25 years and we look forward to his continuing contributions.

In closing, we would like to express once again our thanks to you for your continued confidence and support.

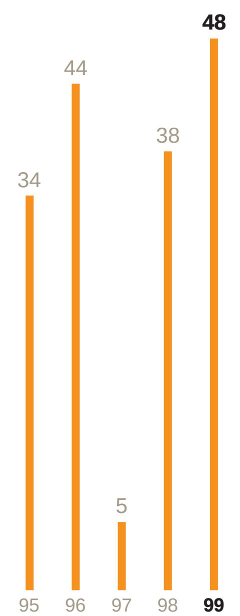
Sincerely,

Lamar Norsworthy
Chairman of the Board and
Chief Executive Officer

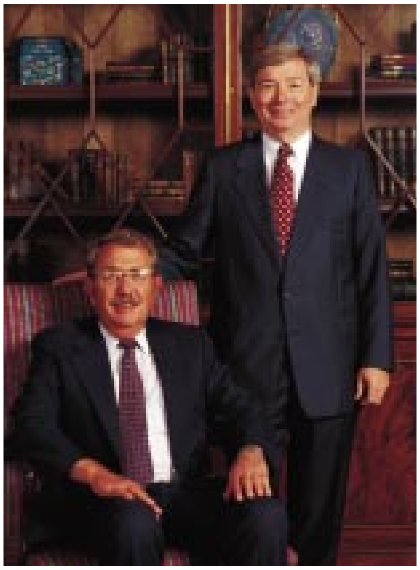
Matthew P. Clifton
President

October 28, 1999

NET CASH PROVIDED BY OPERATING ACTIVITIES
(millions of dollars)



JACK P. REID AND WILLIAM J. GRAY RETIRE



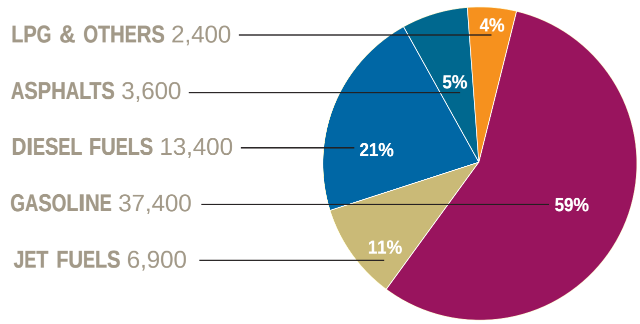
Jack P. Reid (sitting), Holly Corporation's former Executive Vice President, Refining and President of Navajo Refining Company, retired effective August 1, 1999. Jack has played a key leadership role in Navajo Refining Company for the last thirty years. The Company will always be grateful for his leadership and unmatched dedication and loyalty to Navajo Refining Company, its employees, and its community.

William J. Gray (standing), formerly Holly Corporation's Senior Vice President, Marketing and Supply, and Senior Vice President of Navajo Refining Company, retired effective October 1, 1999. Bill's contributions throughout his thirty-year career in leading the Company's marketing and pipeline activities have been important to the success of the Company. His great sense of humor and sincere caring for the Company's employees and the community made Navajo Refinery and Artesia, New Mexico better places to work and live.

Both Jack and Bill will continue to serve as members of Holly's Board of Directors. We thank Jack and Bill for their many years of fine service to the Company and wish each of them a happy retirement.

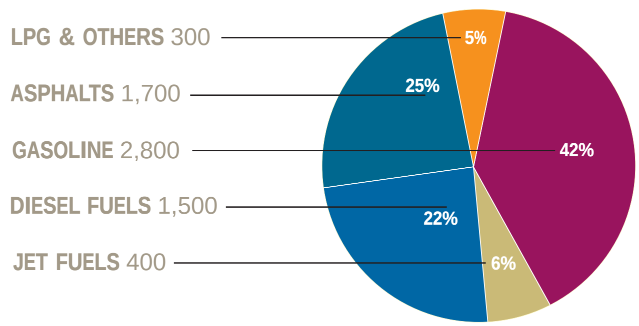
NAVAJO REFINING COMPANY

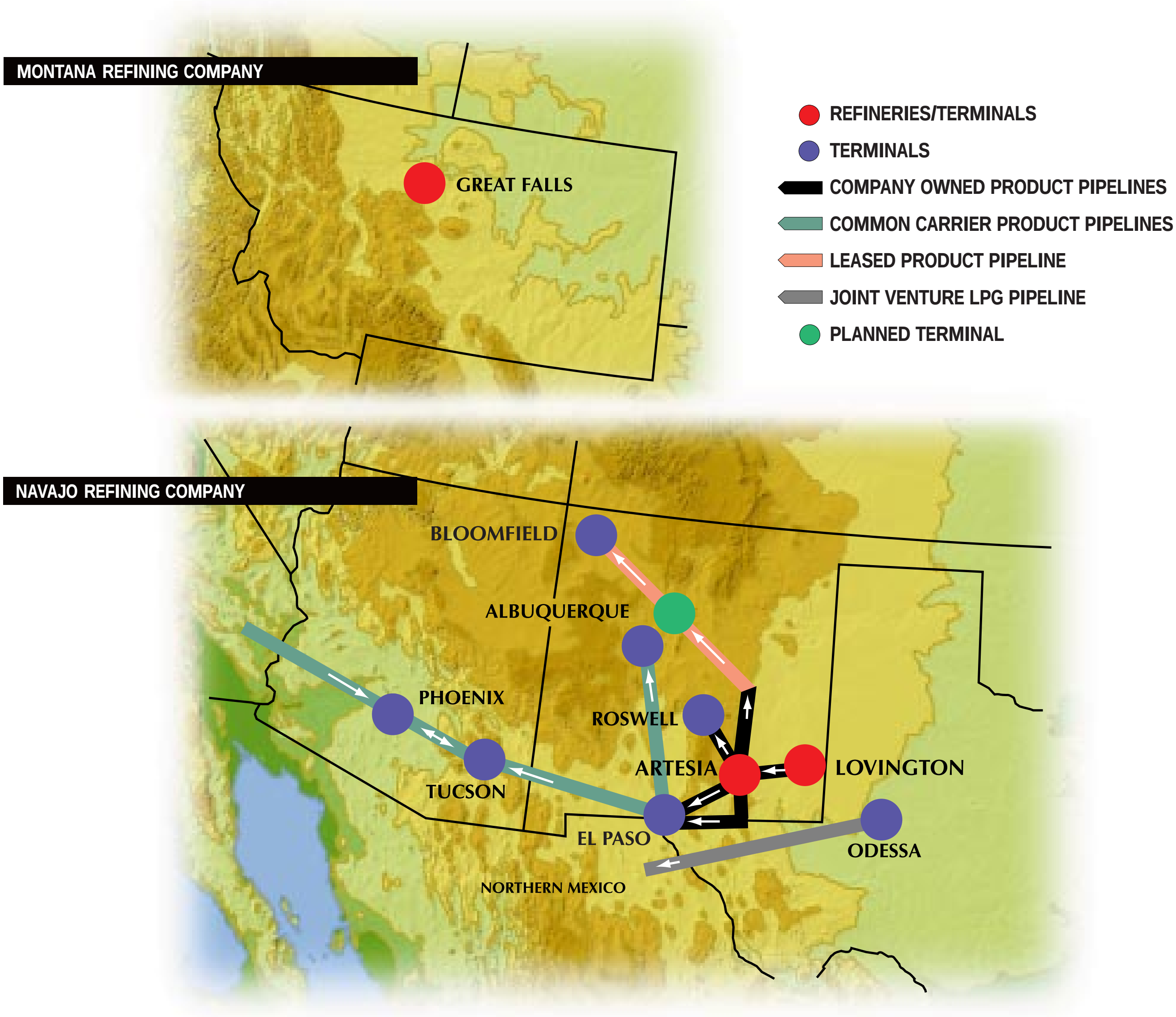
1999 Sales of Refinery Produced Products
63,700 bpd



MONTANA REFINING COMPANY

1999 Sales of Refinery Produced Products
6,700 bpd




MONTANA REFINING COMPANY
GREAT FALLS
REFINERIES/TERMINALS
TERMINALS
COMPANY OWNED PRODUCT PIPELINES
COMMON CARRIER PRODUCT PIPELINES
LEASED PRODUCT PIPELINE
JOINT VENTURE LPG PIPELINE
PLANNED TERMINAL
NAVAJO REFINING COMPANY
BLOOMFIELD
ALBUQUERQUE
PHOENIX
ROSWELL
ARTESIA
LOVINGTON
TUCSON
EL PASO
ODESSA
NORTHERN MEXICO

SELECTED FINANCIAL AND OPERATING DATA

($ in thousands, except per share amounts)

Years ended July 31,	1999	1998	1997	1996	1995
FINANCIAL DATA					
For the year					
Sales and other revenues	$ 597,986	$ 590,299	$ 721,346	$ 676,290	$ 614,830
Income before income taxes and cumulative effect of accounting change	$ 33,159	$ 24,866	$ 21,819	$ 31,788	$ 20,147
Income tax provision	13,222	9,699	8,732	12,554	7,730
Income before cumulative effect of accounting change	19,937	15,167	13,087	19,234	12,417
Cumulative effect of accounting change	–	–	–	–	5,703
Net income	$ 19,937	$ 15,167	$ 13,087	$ 19,234	$ 18,120
Income per common share					
Income before cumulative effect of accounting change (basic and diluted)	$ 2.42	$ 1.84	$ 1.59	$ 2.33	$ 1.51
Cumulative effect of accounting change	–	–	–	–	.69
Net income (basic and diluted)	$ 2.42	$ 1.84	$ 1.59	$ 2.33	$ 2.20
Cash dividends per common share	$ .64	$ .60	$ .51	$ .42	$ .40
Average number of shares of common stock outstanding	8,254,000	8,254,000	8,254,000	8,254,000	8,254,000
Net cash provided by operating activities	$ 47,628	$ 38,193	$ 5,457	$ 44,452	$ 34,241
At end of year					
Working capital	$ 13,851	$ 14,793	$ 45,241	$ 66,649	$ 17,740
Total assets	$ 390,982	$ 349,857	$ 349,803	$ 351,271	$ 287,384
Long-term debt (including current portion)	$ 70,341	$ 75,516	$ 86,291	$ 97,065	$ 68,840
Stockholders' equity	$ 128,880	$ 114,349	$ 105,121	$ 96,243	$ 80,043
OPERATING DATA					
For the year					
Sales of refined products – barrels-per-day	75,400	67,700	69,300	70,300	69,800
Refinery production – barrels-per-day	70,700	61,800	68,600	68,400	68,100

MARKET INFORMATION

The Company's common stock is traded on the American Stock Exchange under the symbol "HOC". The following table sets forth the range of the daily high and low sales prices per share of common stock, dividends paid per share and the trading volume of common stock for the periods indicated:

Fiscal years ended July 31,	High	Low	Dividends	Total Volume
1998				
First Quarter	$ 28 13/16	$ 25 13/16	$ .15	721,200
Second Quarter	28	24 7/8	.15	416,900
Third Quarter	33 3/8	25 5/8	.15	871,500
Fourth Quarter	31 3/4	24 1/8	.15	648,600
1999				
First Quarter	$ 26 1/8	$ 14 3/8	$ .16	1,053,500
Second Quarter	17 3/8	14	.16	712,200
Third Quarter	15 5/8	12 1/4	.16	1,043,700
Fourth Quarter	15 3/4	12 5/8	.16	1,425,900

As of July 31, 1999, the Company had approximately 1,800 stockholders of record.

On September 24, 1999, the Company's Board of Directors declared a regular quarterly dividend in the amount of $.17 per share payable on October 8, 1999. The Company intends to consider the declaration of a dividend on a quarterly basis, although there is no assurance as to future dividends since they are dependent upon future earnings, capital requirements, the financial condition of the Company and other factors. The Senior Notes and Credit Agreement limit the payment of dividends. See Note 6 to the Consolidated Financial Statements.

MANAGEMENTÕS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FACTORS AFFECTING FORWARD-LOOKING STATEMENTS

This Annual Report contains certain “forward-looking statements” within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts included in this Annual Report, including without limitation those under “Liquidity and Capital Resources” and “Additional Factors that May Affect Future Results” under this “Managemen’s Discussion and Analysis of Financial Condition and Results of Operations” regarding the Company’s financial position and results of operations, are forward-looking statements. Such statements are subject to risks and uncertainties, including but not limited to risks and uncertainties with respect to the actions of actual or potential competitive suppliers of refined petroleum products in the Company’s markets, the demand for and supply of crude oil and refined products, the spread between market prices for refined products and crude oil, the possibility of constraints on the transportation of refined products, the possibility of inefficiencies or shutdowns in refinery operations or pipelines, governmental regulations and policies, the availability and cost of financing to the Company, the effectiveness of capital investments and marketing strategies by the Company, the costs of defense and the risk of an adverse decision in the Longhorn Pipeline litigation, the accuracy of technical analysis and evaluations relating to the Year 2000 Problem, and the abilities of third-party suppliers to the Company to avoid adverse effects of the Year 2000 Problem on their capacities to supply the Company. Should one or more of these risks or uncertainties, among others as set forth in this Annual Report or in the Form 10-K Annual Report for the fiscal year ended July 31, 1999, materialize, actual results may vary materially from those estimated, anticipated or projected. Although the Company believes that the expectations reflected by such forward-looking statements are reasonable based on information currently available to the Company, no assurances can be given that such expectations will prove to have been correct. Cautionary statements identifying important factors that could cause actual results to differ materially from the Company’s expectations are set forth in this Annual Report and in the Form 10-K Annual Report for the fiscal year ended July 31, 1999, including without limitation in conjunction with the forward-looking statements included in this Annual Report that are referred to above. All forward-looking statements included in this Annual Report and all subsequent written or oral forward-looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by these cautionary statements.

RESULTS OF OPERATIONS

Financial Data

($ in thousands, except per share data) [1]	Years Ended July 31, 1999	1998	1997
Sales and other revenues	$597,986	$590,299	$721,346
Costs and expenses			
Cost of products sold	428,472	440,042	586,604
Operating expenses	80,654	76,420	70,009
Selling, general and administrative expenses	22,159	13,714	13,348
Depreciation, depletion and amortization	26,358	24,379	20,153
Exploration expenses, including dry holes	1,370	2,979	3,732
	559,013	557,534	693,846
Income from operations	38,973	32,765	27,500
Other			
Equity in earnings of joint ventures	1,965	1,766	414
Interest expense, net	(7,779)	(7,725)	(6,095)
Transaction costs of terminated merger	–	(1,940)	–
	(5,814)	(7,899)	(5,681)
Income before income taxes	33,159	24,866	21,819
Income tax provision	13,222	9,699	8,732
Net income	$ 19,937	$ 15,167	$ 13,087
Income per common share (basic and diluted)	$ 2.42	$ 1.84	$ 1.59
Sales and other revenues [2]			
Refining	$582,172	$582,277	$715,023
Pipeline Transportation	11,936	695	–
Corporate and other	3,878	7,327	6,323
Consolidated	$597,986	$590,299	$721,346
Income (loss) from operations [2]			
Refining	$ 42,118	$ 38,290	$ 33,877
Pipeline Transportation	6,552	302	–
Corporate and other	(9,697)	(5,827)	(6,377)
Consolidated	$ 38,973	$ 32,765	$ 27,500

1) Certain reclassifications have been made to prior reported amounts to conform to current classifications.
2) The Refining segment includes the Company’s principal refinery in Artesia, New Mexico, which is operated in conjunction with refining facilities in Lovington, New Mexico (collectively, the Navajo Refinery) and the Company’s refinery near Great Falls, Montana. The petroleum products produced by Refining segments are marketed in the southwestern United States, Montana and northern Mexico. Certain pipelines and terminals operate in conjunction with the Refining segment as part of the supply and distribution networks of the refineries, which costs are included in the Refining segment. The Pipeline Transportation segment includes approximately 900 miles of the Company’s pipeline assets in Texas and New Mexico. Revenues from the Pipeline Transportation segment are earned through transactions with unaffiliated parties for pipeline transportation, rental and terminalling operations. Included in Corporate and other are costs associated with Holly Corporation, the parent company, consisting primarily of general and administrative expenses and interest charges, as well as a small-scale oil and gas exploration and production program and a small equity investment in retail gasoline stations and convenience stores. Insignificant amounts of intersegment sales were eliminated in consolidation.

Operating Data

	Years Ended July 31,		
	1999	1998	1997
Refinery Production *(BPD)*.......	70,700	61,800	68,600
Sales of Refined Products *(BPD)* [1]	75,400	67,700	69,300
Refinery Margins *(per produced barrel sold)*....	$ 5.91	$ 6.09	$ 5.18

1) Includes refined products purchased for resale of 5,000 BPD, 4,600 BPD and 2,200 BPD, respectively, for the years shown in the above table.

1999 Compared to 1998

For the year ended July 31, 1999, net income was $19.9 million ($2.42 per share), as compared to $15.2 million ($1.84 per share) for fiscal 1998. The increase in net income for fiscal 1999 was primarily attributable to increased refined product sales volumes and increased pipeline transportation income, partially offset by lower refinery margins and increased selling, general and administrative expenses.

Refinery margins decreased 3.0% during fiscal 1999 compared to the prior year, as product prices decreased at a slightly greater rate than crude prices. However, the Company experienced higher refinery margins in April through July 1999 as product prices increased at a greater rate than crude prices in the California refined products market, which impacts product pricing for the Company's Navajo Refinery in New Mexico. Such margins have declined since that time. Increased production volumes of 14.4% for fiscal 1999 more than offset the reduced margins, compared to fiscal 1998, when such volumes were reduced due to a turnaround at the Navajo Refinery. Refined product revenues did not change significantly as the decrease in product prices was offset by the increase in sales volumes, due principally to the increased production at the Navajo Refinery. Refining operating expenses were relatively constant from year-to-year.

Pipeline Transportation revenues increased significantly as the result of the initiation of pipeline and terminalling related revenues under agreements with FINA, Inc. and from operation of a West Texas crude oil gathering system the Company purchased in June 1998. Additionally, the Company began generating transportation revenues in June 1999 from deliveries of isobutane to another refinery. Most of the increase in operating expenses for the Company results from the increased pipeline transportation operations.

Earnings were negatively impacted in the 1999 fiscal year, as compared to the prior year, by an increase in general and administrative expenses relating principally to legal proceedings and non-recurring compensation expense, partially offset by charges in fiscal 1998 in connection with the terminated merger with Giant Industries, Inc. Additionally, earnings were impacted during fiscal 1999 relative to fiscal 1998 by lower oil and gas income due to decreased prices for oil and gas and a reduction in scope of the Company's oil and gas program, and increases in depreciation and amortization expenses resulting primarily from the prior year's turnaround expenditures and the increase in pipeline transportation operations.

1998 Compared to 1997

For the 1998 fiscal year, net income was $15.2 million ($1.84 per share) as compared to $13.1 million ($1.59 per share) for fiscal 1997. Transaction costs associated with the planned merger with Giant Industries, Inc., which was terminated, reduced earnings by $1.2 million ($.14 per share) for the 1998 fiscal year.

The increase in income in the 1998 fiscal year compared to 1997 was principally due to increased refinery margins of 17.6%. Refined product revenues decreased in the year ended July 31, 1998 from the prior year as a result of reduced sales prices and reduced overall sales volumes for the 1998 fiscal year, due principally to decreased production at the Navajo Refinery. Refinery margins increased significantly during the fourth quarter of fiscal 1998 as crude oil prices decreased at a faster rate than refined product prices in the Company's markets. However, a 9.9% reduction in production of refined products partially offset the year-over-year refinery margin increases.

The reduced production for the 1998 fiscal year resulted from a planned maintenance shutdown (a "turnaround") at the Company's Navajo Refinery. The turnaround, which is scheduled approximately every four years, was conducted in the first quarter and early part of the second quarter of fiscal 1998. This turnaround included an upgrade of the fluid catalytic cracking unit ("FCC") to more efficient technology. The effects of this upgrade, combined with the effects of the isomerization unit which became operational at the end of the prior fiscal year, have substantially improved the high value product yields of the Navajo facility. The increase in these yields contributed favorably to refinery margins beginning in the second quarter of fiscal 1998. Earnings in fiscal 1998 were adversely impacted by an increase in depreciation, depletion and amortization resulting from the amortization of higher turnaround costs beginning in the second quarter. Additionally impacting earnings for the 1998 fiscal year was the inclusion in operating expenses of costs associated with the lease of 300 miles of 8" pipeline which began late in the fourth quarter of fiscal 1997. The Company plans to utilize this pipeline to transport petroleum products from the Navajo Refinery to markets in Albuquerque and northwest New Mexico during the 2000 fiscal year. Earnings for fiscal 1998 were also impacted by a decrease in interest income due to a lower level of cash investments in fiscal 1998 as compared to fiscal 1997.

LIQUIDITY AND CAPITAL RESOURCES

Cash and cash equivalents increased during the year ended July 31, 1999 by $1.6 million to $4.2 million, as cash flows from operations were greater than capital expenditures, principal repayments, including the repayment of $11.6 million which represents all outstanding borrowings under the Credit Agreement, and dividend payments. Subsequent to July 31, 1999, the Company has generated cash balances in excess of its ongoing liquidity requirements. The Company believes that this cash, in conjunction with its Credit Agreement, which can be used for direct borrowings of up to $50 million and which will expire in October 2000 unless extended, together with future cash flows from operations, should provide sufficient resources to enable the Company to satisfy its liquidity needs, capital requirements, and debt service obligations while continuing the payment of dividends for at least the next twelve months.

Cash Flows from Operating Activities

Net cash provided by operating activities amounted to $47.6 million in fiscal 1999, compared to $38.2 million in fiscal 1998 and $5.5 million in fiscal 1997. Comparing fiscal 1999 to fiscal 1998, the increase in cash provided from operating activities was principally due to expenditures of $18.8 million incurred in fiscal 1998 relating to the Navajo turnaround, offset partially by changes in working capital items. Comparing fiscal 1998 to fiscal 1997, cash provided from operating activities was significantly higher. The increase was principally due to an increase in cash generated by earnings, offset partially by higher expenditures incurred in fiscal 1998 relating to the Navajo turnaround compared to similar but smaller advance expenditures in the latter part of fiscal 1997 and offset by a $19.6 million increase in inventories during 1997, primarily related to preparation for the turnaround in fiscal 1998. A significant portion of this inventory increase was liquidated in fiscal 1998; however the impact of this inventory liquidation was reduced because of an increase in inventory caused by the Company's purchase of the West Texas crude gathering system.

Cash Flows for Financing Activities

Cash flows used for financing activities amounted to $22.1 million in fiscal 1999, compared to $4.7 million in fiscal 1998 and $15.0 million in fiscal 1997.

During 1999, increased cash flows from operating activities and lower capital expenditures relative to 1998 enabled the Company to retire its outstanding bank debt, make scheduled amortization payments on the Senior Notes and pay $5.3 million in dividends. In 1998, higher capital expenditure requirements and dividend payments of $5.0 million more than offset higher cash flow from operating activities, resulting in an outstanding balance of $11.6 million under the Credit Agreement.

The Company believes its internally generated cash flow, along with its Credit Agreement, provides sufficient resources to fund capital projects, scheduled repayments of the Senior Notes, continued payment of dividends (although dividend payments must be approved by the Board of Directors and cannot be guaranteed) and the Company's liquidity needs for at least the next twelve months. The Company's Credit Agreement expires in October 2000, and the Company has recently initiated discussions with its banks on an extension of the Credit Agreement. While the Company expects such negotiations to result in the extension of the Credit Agreement, there can be no assurance that such negotiations will be successful.

See Note 6 to the Consolidated Financial Statements for a summary of the terms and conditions of the Senior Notes and of the Credit Agreement.

Cash Flows for Investing Activities and Capital Projects

Cash flows used for investing activities totalled $109.3 million over the last three years, $24.0 million in 1999, $51.0 million in 1998 and $34.4 million in 1997. All of these amounts were expended on capital projects with the exceptions of $2.0 million during fiscal 1998 invested in a joint venture to operate retail gasoline stations and convenience stores in Montana, $3.0 million invested during 1998 in shares of common stock of a publicly traded company and $4.1 million invested during 1997 in the Rio Grande joint venture described below. The net negative cash flow for investing activities was offset by distributions to the Company from the Rio Grande joint venture of $2.9 million in fiscal 1999 and $3.7 million in fiscal 1998.

The Company has adopted a capital budget of $23 million for fiscal 2000. The components of this budget are $9 million for various refinery improvements, $9 million for costs relating to the purchase of a gasoil hydrotreater, as described below, $4 million for various pipeline and transportation projects and under $1 million for oil and gas exploration and production activities. In addition to these projects, the Company plans to expend during 2000 a total of $8 million on items that were approved in previous capital budgets primarily relating to pipeline and terminalling activities.

As part of its efforts to improve operating efficiencies, the Company constructed an isomerization unit and upgraded the FCC unit at the Navajo Refinery. The isomerization unit, which was completed in February 1997, increases the refinery's internal octane generating capabilities, thereby improving light product yields and increasing the refinery's ability to upgrade additional amounts of lower priced purchased natural gasoline into finished gasoline. The upgrade of the refinery's FCC unit, which was implemented during the Navajo Refinery's scheduled turnaround in the first quarter and early part of the second quarter of fiscal 1998, improves the yield of high value products from the FCC unit by incorporating certain state-of-the-art upgrades.

In addition to the above projects, the Company purchased a hydrotreater unit for $5 million from a closed refinery in November 1997. This purchase should give the Company the ability to reconstruct the unit at the Navajo Refinery at a substantial savings relative to the purchase cost of a new unit. The hydrotreater will enhance higher value, light product yields and facilitate the Company's ability to meet the present California Air Resources Board ("CARB") standards, which have been adopted in the Company's Phoenix market for winter months beginning in the latter part of 2000. Included in the fiscal 2000 capital budget are commitments related to the hydrotreater of $9 million, which include costs to relocate the unit to the Navajo Refinery and construct a sulfur recovery unit, which will be immediately utilized and work in conjunction with the hydrotreater when completed, and certain long-lead-time pieces of equipment. The Company, subject to obtaining necessary permitting in a timely manner, expects to complete the hydrotreater in the latter part of 2001. Remaining costs to complete the hydrotreater are estimated to be approximately $20 million, in addition to the current $9 million budgeted amount. Based on the current configuration at the Navajo Refinery, the Company believes it can supply current sales volumes into the Phoenix market under the CARB standards prior to completion of the hydrotreater.

The Company has leased from Mid-America Pipeline Company more than 300 miles of 8" pipeline running from Chavez County to San Juan County, New Mexico (the "Leased Pipeline"). The Company has completed a 12" pipeline from the Navajo Refinery to the Leased Pipeline as well as terminalling facilities in Bloomfield. The Company is in the process of completing the construction of a diesel fuel terminal 40 miles east of Albuquerque in Moriarty and is considering different alternatives regarding its terminalling needs in Albuquerque. When the project, including the Albuquerque portion, is completed, these facilities will allow the Company to use the Leased Pipeline to transport petroleum products from the Navajo Refinery to Albuquerque and markets in northwest New Mexico. Transportation of petroleum products to markets in northwest New Mexico and diesel fuels to Moriarty, New Mexico, near Albuquerque, are planned to begin in late 1999.

The Company has a 25% interest in a pipeline joint venture ("Rio Grande") with Mid-America Pipeline Company and Amoco Pipeline Company to transport liquid petroleum gases to Mexico. Deliveries by the joint venture began in April 1997. In October 1996, the Company completed a new 12" refined products pipeline from Orla to El Paso, Texas, which replaced a portion of an 8" pipeline previously used by Navajo that was transferred to Rio Grande. Discussions regarding expansion of this line are currently underway.

The additional pipeline capacity resulting from the new pipelines constructed in conjunction with the Rio Grande joint venture and from the Leased Pipeline should reduce pipeline operating expenses at existing throughputs. In addition, the new pipeline capacity will allow the Company to increase volumes, through refinery expansion or otherwise, that are shipped into existing and new markets and could allow the Company to shift volumes among markets in response to any future increased competition in particular markets.

In the fourth quarter of fiscal 1998, the Company purchased from Fina Oil and Chemical Company a crude oil gathering system in West Texas. The assets purchased include approximately 500 miles of pipelines and over 350,000 barrels of tankage. Approximately 23,000 barrels per day of crude oil were gathered on these systems in fiscal 1999. The Company believes that these assets should generate a stable source of transportation service income, and will give Navajo the ability to purchase crude oil at the lease in new areas, thus potentially enhancing the stability of crude oil supply and refined product margins for the Navajo Refinery.

During the fourth quarter of fiscal 1999, the Company completed 65 miles of new pipeline between Lovington and Artesia, New Mexico, to permit the delivery of isobutane (and/or other LPGs) to an unrelated refiner in El Paso as well as to increase the Company's ability to access additional raw materials.

The Company announced in February 1997 the formation of an alliance with FINA, Inc. ("FINA") to create a comprehensive supply network that can increase substantially the supplies of gasoline and diesel fuel in the West Texas, New Mexico, and Arizona markets to meet expected increasing demand in the future. FINA constructed a 50-mile pipeline which connected an existing FINA pipeline system to the Company's 12" pipeline between Orla, Texas and El Paso, Texas pursuant to a long-term lease of certain capacity of the Company's 12" pipeline. In August 1998, FINA began transporting to El Paso gasoline and diesel fuel from its Big Spring, Texas refinery. Pursuant to a long-term lease agreement, FINA will ultimately have the right to transport up to 20,000 BPD to El Paso on this interconnected system. In August 1998, the Company began to realize pipeline rental and terminalling revenues from FINA under these agreements.

ADDITIONAL FACTORS THAT MAY AFFECT FUTURE RESULTS

The Company's operating results have been, and will continue to be, affected by a wide variety of factors, many of which are beyond the Company's control, that could have adverse effects on profitability during any particular period. Among these factors is the demand for crude oil and refined products, which is largely driven by the conditions of local and worldwide economies as well as by weather patterns and the taxation of these products relative to other energy sources. Governmental regulations and policies, particularly in the areas of taxation, energy and the environment, also have a significant impact on the Company's activities. Operating results can be affected by these industry factors, by competition in the particular geographic markets that the Company serves and by factors that are specific to the Company, such as the success of particular marketing programs and the efficiency of the Company's refinery operations.

In addition, the Company's profitability depends largely on the spread between market prices for refined petroleum products and crude oil prices. This margin is continually changing and may significantly fluctuate from time to time. Crude oil and refined products are commodities whose price levels are determined by market forces beyond the control of the Company. Additionally, due to the seasonality of refined products markets and refinery maintenance schedules, results of operations for any particular quarter of a fiscal year are not necessarily indicative of results for the full year. In general, prices for refined products are significantly influenced by the price of crude oil. Although an increase or decrease in the price for crude oil generally results in a similar increase or decrease in prices for refined products, there is normally a time lag in the realization of the similar increase or decrease in prices for refined products. The effect of changes in crude oil prices on operating results therefore depends in part on how quickly refined product prices adjust to reflect these changes. A substantial or prolonged increase in crude oil prices without a corresponding increase in refined product prices, a substantial or prolonged decrease in refined product prices without a corresponding decrease in crude oil prices, or a substantial or prolonged decrease in demand for refined products could have a significant negative effect on the Company's earnings and cash flows.

The Company is dependent on the production and sale of quantities of refined products at margins sufficient to cover operating costs, including any increases in costs resulting from future inflationary pressures. The refining business is characterized by high fixed costs resulting from the significant capital outlays associated with refineries, terminals, pipelines and related facilities. Furthermore, future regulatory requirements or competitive pressures could result in additional capital expenditures, which may or may not produce the results intended. Such capital expenditures may require significant financial resources that may be contingent on the Company's continued access to capital markets and commercial bank markets. Additionally, other matters, such as regulatory requirements or legal actions may restrict the Company's continued access.

Until 1998, the El Paso market and markets served from El Paso were generally not supplied by refined products produced by the large refineries on the Texas Gulf Coast. While wholesale prices of refined products on the Gulf Coast have historically been lower than prices in El Paso, distances from the Gulf Coast to El Paso (more than 700 miles if the most direct route is used) have made transportation by truck unfeasible and have discouraged the substantial investment required for development of refined products pipelines from the Gulf Coast to El Paso.

In 1998, a Texaco, Inc. subsidiary completed a 16-inch refined products pipeline running from the Gulf Coast to Midland, Texas along a northern route (through Corsicana, Texas). This pipeline, now owned by Equilon Enterprises LLC ("Equilon"), is linked to a 6-inch pipeline, also owned by Equilon, that is currently being used to transport to El Paso approximately 18,000 BPD of refined products that are produced on the Texas Gulf Coast (this volume replaces a similar volume produced in the Shell Oil Company refinery in Odessa, Texas, which was recently shut down). The Equilon line from the Gulf Coast to Midland has the potential to be linked to existing or new pipelines running from the Midland, Texas area to El Paso with the result that substantial additional volumes of refined products could be transported from the Gulf Coast to El Paso.

An additional potential source of pipeline transportation from Gulf Coast refineries to El Paso is the proposed Longhorn Pipeline. This pipeline is proposed to run approximately 700 miles from the Houston area of the Gulf Coast to El Paso, utilizing a direct route. The owner of the Longhorn Pipeline, Longhorn Partners Pipeline, L.P., a Delaware limited partnership that includes affiliates of Exxon Pipeline Company, BP/Amoco Pipeline Company, Williams Pipeline Company, and the Beacon Group Energy Investment Fund, L.P. and Chisholm Holdings as limited partners ("Longhorn Partners"), has proposed to use the pipeline initially to transport approximately 72,000 BPD of refined products from the Gulf Coast to El Paso and markets served from El Paso, with an ultimate maximum capacity of 225,000

BPD. A critical feature of this proposed petroleum products pipeline is that it would utilize, for approximately 450 miles (including areas overlying the environmentally sensitive Edwards Aquifer and Edwards-Trinity Aquifer and heavily populated areas in the southern part of Austin, Texas) an existing pipeline (previously owned by Exxon Pipeline Company) that was constructed in about 1950 for the shipment of crude oil from West Texas to the Houston area.

The Longhorn Pipeline is not currently operating because of a federal court injunction in August 1998 and a settlement agreement in March 1999 entered into by Longhorn Partners, the United States Environmental Protection Agency ("EPA") and Department of Transportation ("DOT"), and the other parties to the federal lawsuit that had resulted in the injunction. The March 1999 settlement agreement required the preparation of an Environmental Assessment under the authority of the EPA and the DOT. A draft Environmental Assessment (the "Draft EA") on the Longhorn Pipeline was released on October 22, 1999. The Draft EA proposes a preliminary Finding of No Significant Impact with respect to the Longhorn Pipeline provided that Longhorn Partners carries out a proposed mitigation plan developed by Longhorn Partners which contains 34 elements. Some of the elements of the proposed mitigation plan are required to be completed before the Longhorn Pipeline is allowed to operate, with the remainder required to be completed later or to be implemented for as long as operations continue. Public comments on the Draft EA may be submitted to the EPA and DOT until the end of November 1999 and in November 1999 there will be a series of five public meetings on the Draft EA at specified locations in Texas. The Company believes that public comments will raise questions concerning certain elements of the Draft EA. A final determination by the EPA and DOT with respect to the matters considered in the Draft EA could be issued as early as 30 days following the end of the public comment period.

If the Longhorn Pipeline is allowed to operate as currently proposed, the substantially lower requirement for capital investment would permit Longhorn Partners to give its shippers a cost advantage through lower tariffs that could, at least for a period, result in significant downward pressure on wholesale refined products prices and refined products margins in El Paso and related markets. Although some current suppliers in the market might not compete in such a climate, the Company's analyses indicate that, because of location and recent capital improvements, the Company's position in El Paso and markets served from El Paso could withstand such a period of lower prices and margins. However, the Company's results of operations could be adversely impacted if the Longhorn Pipeline were allowed to operate as currently proposed. It is not possible to predict whether and, if so, under what conditions, the Longhorn Pipeline ultimately will be allowed to operate, nor is it possible to predict the consequences for the Company of Longhorn Pipeline's operations if they occur.

In August 1998, a lawsuit (the "Longhorn Suit") was filed by Longhorn Partners in state district court in El Paso, Texas against the Company and two of its subsidiaries (along with an Austin, Texas law firm which was subsequently dropped from the case). The suit, as amended by Longhorn Partners in March 1999, seeks damages alleged to total up to $1,050,000,000 (after trebling) based on claims of violations of the Texas Free Enterprise and Antitrust Act, unlawful interference with existing and prospective contractual relations, and conspiracy to abuse process. The specific action of the Company complained of in the Longhorn Suit is the support of lawsuits brought by ranchers in West Texas to challenge the proposed use by the Longhorn Pipeline of easements and rights-of-way that were granted over 50 years ago for the Exxon crude oil pipeline. The Company believes that the Longhorn Suit is wholly without merit and plans to defend itself vigorously. The Company also plans to pursue at the appropriate time any affirmative remedies that may be available to it relating to the Longhorn Suit.

In April 1999, the Williams Companies and Equilon Enterprises LLC (a joint venture of Texaco Inc. and the Royal Dutch/Shell Group) announced a 1,010-mile pipeline, called the "Aspen Pipeline," to carry gasoline and other refined fuels from Texas to Utah. It was announced that the pipeline would have a capacity of 65,000 BPD and shipments will begin in late 2000. In addition to the pipeline, product terminals would be built, including a terminal in Albuquerque, New Mexico. This venture could result in an increase in the supply of products to some of the Company's markets.

An additional factor that could affect the Company's market is excess pipeline capacity from the West Coast into the Company's Arizona markets after the pipeline's expansion this year. If additional refined products become available on the West Coast in excess of demand in that market, additional products may be shipped into the Company's Arizona markets with resulting possible downward pressure on refined product prices in the Company's markets.

In addition to the projects described above, other projects have been explored from time to time by refiners and other entities, which projects, if consummated, could result in a further increase in the supply of products to some or all of the Company's markets.

In recent years there have been several refining and marketing consolidations or acquisitions between entities competing in the Company's geographic market. While these transactions could increase the competitive pressures on the Company, the specific ramifications of these or other potential consolidations cannot presently be determined.

The common carrier pipelines used by the Company to serve the Arizona and Albuquerque markets are currently operated at or near capacity and are subject to proration. As a result, the volumes of refined products that the Company and other shippers have been able to deliver to these markets have been limited. The flow of additional products into El Paso for shipment to Arizona, either as a result of the Longhorn Pipeline or otherwise, could further exacerbate such constraints on deliveries to Arizona. No assurances can be given that the Company will not experience future constraints on its ability to deliver its products through the pipelines to Arizona. In the case of the Albuquerque market, the common carrier pipeline used by the Company to serve this market currently operates at or near capacity with resulting limitations on the amount of refined products that the Company and other shippers can deliver. As previously discussed, the Company has entered into a Lease Agreement for a pipeline between Artesia and the Albuquerque vicinity and Bloomfield, New Mexico with Mid-America Pipeline Company. The Company has completed a refined products terminal in Bloomfield and is completing construction of a diesel fuel terminal east of Albuquerque. The Company is also in the process of pursuing different alternatives to address terminalling needs in Albuquerque. While the Company is proceeding as expeditiously as possible on the Albuquerque project, it is not possible at present to determine when the project will be completed. Completion of this project would allow the Company to transport products directly to Albuquerque on the leased pipeline, thereby eliminating third party tariff expenses and the risk of future pipeline constraints on shipments to Albuquerque. Any future constraints on the Company's ability to transport its refined products to Arizona or Albuquerque could, if sustained, adversely affect the Company's results of operations and financial condition.

Effective January 1, 1995, certain cities in the country were required to use only reformulated gasoline ("RFG"), a cleaner burning fuel. Phoenix is the only principal market of the Company that currently requires RFG although this requirement could be implemented in other markets over time. Phoenix has adopted even more rigorous California Air Resources Board ("CARB") fuel specifications for winter months beginning in the latter part of 2000. This new requirement, other requirements of the federal Clean Air Act or other presently existing or future environmental regulations could cause the Company to expend substantial amounts to permit the Company's refineries to produce products that meet applicable requirements. Completion of the hydrotreater, discussed above, will help the Company to meet these requirements.

Risk Management

The Company uses certain strategies to reduce some commodity price and operational risks. The Company does not attempt to eliminate all market risk exposures when the Company believes the exposure relating to such risk would not be significant to the Company's future earnings, financial position, capital resources or liquidity or that the cost of eliminating the exposure would outweigh the benefit.

The Company's profitability depends largely on the spread between market prices for refined products and crude oil. A substantial or prolonged decrease in this spread could have a significant negative effect on the Company's earnings, financial condition and cash flows. At times, the Company utilizes petroleum commodity futures contracts to minimize a portion of its exposure to price fluctuations associated with crude oil and refined products. Such contracts are used solely to help manage the price risk inherent in purchasing crude oil in advance of the delivery date and as a hedge for fixed-price sales contracts of refined products and do not increase the market risks to which the Company is exposed. Gains and losses on contracts are deferred and recognized in cost of refined products when the related inventory is sold or the hedged transaction is consummated. No such contracts were outstanding at July 31, 1999.

At July 31, 1999, the Company had outstanding unsecured debt of $70.3 million and had no borrowings outstanding under its Credit Agreement. The Company does not have significant exposure to changing interest rates on its unsecured debt because the interest rates are fixed, the average maturity is approximately three years and such debt represents less than 40% of the Company's total capitalization. During much of fiscal 1999, the Company had outstanding borrowings under the Credit Agreement. Since interest rates on borrowings are reset frequently based on either the bank's daily effective prime rate, or the LIBOR rate, interest rate market risk is very low. Additionally, the Company invests any available cash only in investment grade, highly liquid investments with maturities of three months or less. As a result, the interest rate market risk implicit in these cash investments is low, as the investments mature within three months. A ten percent change in the market interest rate over the next year would not materially impact the Company's earnings or cash flow, as the interest rates on the Company's long-term debt are fixed, and the Company's borrowings under the Credit Agreement and cash investments are at short-term market rates and such interest has historically not been significant as compared to the total operations of the

Company. A ten percent change in the market interest rate over the next year would not materially impact the Company's financial condition, as the average maturity of the Company's long-term debt is approximately three years and such debt represents less than 40% of the Company's total capitalization, and the Company's borrowings under the Credit Agreement and cash investments are at short-term market rates.

The Company's operations are subject to normal hazards of operations, including fire, explosion and weather-related perils. The Company maintains various insurance coverages, including business interruption insurance, subject to certain deductibles. The Company is not fully insured against certain risks because such risks are not fully insurable, coverage is unavailable or premium costs, in the judgement of the Company, do not justify such expenditures.

The Year 2000 Problem

The Year 2000 Problem is the result of older computer systems using a two-digit format rather than a four-digit format to define the applicable year with the result that such computer systems may be unable to interpret properly dates beyond the year 1999. This inability could lead to a failure of information systems and disruptions of business and financial operations. Year 2000 risks exist both in information technology ("IT") systems that employ computer hardware and software and in non-IT systems such as embedded computer chips or microcontrollers that control the operation of the equipment in which they are installed. Computer failures because of the Year 2000 Problem could affect the Company either because of failures of computers used in the Company's operations and record-keeping or because of computer failures that adversely affect third parties that are suppliers to or customers of the Company.

Partly with the assistance of outside consultants, the Company has taken steps to identify key financial, informational and operational systems that may be affected by the Year 2000 Problem. Based on certifications by third-party suppliers of the Company's principal IT systems, the Company believes that its principal IT systems either are now unaffected by the Year 2000 Problem or have been upgraded to make these systems free of Year 2000 issues.

The Company has made an inventory of non-IT systems embedded in equipment used in the Company's operations and has assessed the extent to which these non-IT systems could fail because of the Year 2000 Problem and thereby cause significant problems for the Company's operations, financial condition or liquidity. The Company has identified, based on information and/or certifications from suppliers or other third parties, the types of non-IT systems that appear to be significantly at risk of failure due to the Year 2000 Problem; the Company believes that it has remediated all items of equipment containing at-risk chips. Because of the nature of the non-IT systems, there can be no assurance that the Company has correctly identified all non-IT systems that are subject to failure because of the Year 2000 Problem. Any failure of non-IT systems because of the Year 2000 Problem could reduce production levels or potentially shut down the refinery operations of the Company.

To the extent possible, the Company has either tested or received certifications with respect to all significant IT and non-IT systems.

The Company has also initiated contingency planning to respond to the possible effects of the Year 2000 Problem on third parties that are important to the Company's operations. The Company is communicating regularly on this issue with critical third parties, such as suppliers of power or telecommunications services to the Company's operational facilities, third-party carriers of raw materials and refined products, and major customers. As problems of third parties are identified during the preparation of the contingency plan, the Company will take any steps available to mitigate the impact on the Company of a failure in a third party caused by the Year 2000 Problem. While the Company believes that it has made adequate arrangements to deal with these contingencies, it continues to update such plans as additional information becomes available.

The cost to the Company of dealing with the Year 2000 Problem is not expected to be material. Although a portion of the time of IT personnel and related management has been and will be employed in evaluating the problem, taking corrective actions and preparing contingency plans, the Company does not believe that other IT projects or operations have been or will be adversely affected. Monetary costs expected to be involved in dealing with the Year 2000 Problem are not expected to be significant: all costs to the Company of review, analysis and corrective action (excluding IT system upgrades that were scheduled to be implemented without regard to the Year 2000 Problem) are expected to be slightly less than $1 million, most of which has been incurred.

Based on the analysis performed to this point, the Company believes that the most important Year 2000 risk to the Company's results of operations and financial condition is that third-party suppliers important to the operations of the Company's principal operating assets, the Navajo Refinery at Artesia and Lovington, New Mexico and the Montana Refinery near Great Falls, Montana, would for a period of time be unable to perform their normal roles because of difficulties created by the Year 2000 Problem for the third parties and/or for persons supplying the third parties. The Company believes that its most significant risk would be in the case of the Company's principal or sole sources for essential inputs — for example power to operate a refinery. If such a provider were to be unable to continue supplying the refinery because of the Year 2000 Problem, the Company could be forced to suspend the affected operations until the provider could solve the problem or in some cases until an alternative supply could be arranged. The Company intends to continue until the year 2000 regular contacts with critical suppliers to determine their evaluations of vulnerability to the Year 2000 Problem. In the event that a particular supplier appears to be vulnerable, the Company will seek to obtain alternative supplies to the extent they are available. However, in the case of some inputs, alternative supplies may not realistically be available even if the supply problem is identified months in advance. In other cases, an unexpected third-party failure could occur in spite of extensive prior communications with key suppliers and the only feasible remedy to the Company for a substantial period might be emergency corrective action by the affected third party if the third party were capable of taking such action.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires that all derivatives be recognized as either assets or liabilities in the statement of financial position and that those instruments be measured at fair value. SFAS No. 133 also prescribes the accounting treatment for changes in the fair value of derivatives which depends on the intended use of the derivative and the resulting designation. Designations include hedges of the exposure to changes in the fair value of a recognized asset or liability, hedges of the exposure to variable cash flows of a forecasted transaction, hedges of the exposure to foreign currency translations, and derivatives not designated as hedging instruments. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." Under SFAS No. 137, SFAS No. 133 becomes effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 with early adoption permitted. The Company has not completed evaluating the effects this statement will have on its financial reporting and disclosures.

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors
and Stockholders of Holly Corporation

We have audited the accompanying consolidated balance sheet of Holly Corporation at July 31, 1999 and 1998, and the related consolidated statements of income, cash flows, stockholders' equity and comprehensive income for each of the three years in the period ended July 31, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Holly Corporation at July 31, 1999 and 1998, and the consolidated results of its operations and its cash flows for each of the three years in the period ended July 31, 1999, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Dallas, Texas
September 22, 1999

CONSOLIDATED BALANCE SHEET

($ in thousands, except per share amounts)

July 31,	1999	1998
ASSETS		
Current assets		
Cash and cash equivalents	$ 4,194	$ 2,602
Accounts receivable (Notes 3 and 6)	123,502	82,379
Inventories (Notes 4 and 6)	54,924	55,842
Income taxes receivable	–	653
Prepayments and other	12,158	12,911
Total current assets	194,778	154,387
Properties, plants and equipment, net (Note 5)	180,894	173,297
Investments in and advances to joint ventures	4,035	5,510
Other assets	11,275	16,663
Total assets	$ 390,982	$ 349,857
LIABILITIES AND STOCKHOLDERSÕ EQUITY		
Current liabilities		
Accounts payable (Note 3)	$ 144,287	$ 109,139
Accrued liabilities (Notes 9 and 11)	14,688	13,392
Income taxes payable	8,206	288
Current maturities of long-term debt (Note 6)	13,746	5,175
Borrowings under credit agreement (Note 6)	–	11,600
Total current liabilities	180,927	139,594
Deferred income taxes (Note 7)	24,580	25,573
Long-term debt, less current maturities (Note 6)	56,595	70,341
Commitments and contingencies (Notes 10 and 11)		
StockholdersÕ equity (Notes 6 and 8)		
Preferred stock, $1.00 par value – 1,000,000 shares authorized; none issued	–	–
Common stock, $.01 par value – 20,000,000 shares authorized; 8,650,282 shares issued	87	87
Additional capital	6,132	6,132
Retained earnings	124,341	109,686
	130,560	115,905
Common stock held in treasury, at cost – 396,768 shares	(569)	(569)
Other comprehensive loss	(1,111)	(987)
Total stockholdersÕ equity	128,880	114,349
Total liabilities and stockholdersÕ equity	$ 390,982	$ 349,857

See accompanying notes.

CONSOLIDATED STATEMENT OF INCOME

($ in thousands, except per share amounts)

Years ended July 31,	1999	1998	1997
Sales and other revenues (Note 13)	$ 597,986	$ 590,299	$ 721,346
Operating costs and expenses			
Cost of products sold	428,472	440,042	586,604
Operating expenses	80,654	76,420	70,009
Selling, general and administrative expenses	22,159	13,714	13,348
Depreciation, depletion and amortization	26,358	24,379	20,153
Exploration expenses, including dry holes	1,370	2,979	3,732
Total operating costs and expenses	559,013	557,534	693,846
Income from operations	38,973	32,765	27,500
Other income (expense)			
Equity in earnings of joint ventures	1,965	1,766	414
Interest income	11	646	3,244
Interest expense (Note 6)	(7,790)	(8,371)	(9,339)
Transaction costs of terminated merger (Note 14)	–	(1,940)	–
	(5,814)	(7,899)	(5,681)
Income before income taxes	33,159	24,866	21,819
Income tax provision (benefit) (Note 7)			
Current	13,489	3,121	7,251
Deferred	(267)	6,578	1,481
	13,222	9,699	8,732
Net income	$ 19,937	$ 15,167	$ 13,087
Net income per common share (basic and diluted)	$ 2.42	$ 1.84	$ 1.59
Cash dividends paid per common share	$ .64	$ .60	$ .51
Average number of shares of common stock outstanding (in thousands)	8,254	8,254	8,254

See accompanying notes.

CONSOLIDATED STATEMENT OF CASH FLOWS

($ in thousands)

Years ended July 31,	1999	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$ 19,937	$ 15,167	$ 13,087
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation, depletion and amortization	26,358	24,379	20,153
Deferred income taxes	(267)	6,578	1,481
Equity in earnings of joint ventures	(1,965)	(1,766)	(414)
Dry hole costs and leasehold impairment	256	1,190	1,760
(Increase) decrease in current assets			
Accounts receivable	(41,123)	23,442	(1,435)
Inventories	918	2,431	(19,600)
Income taxes receivable	653	666	(1,319)
Prepayments and other	(44)	746	(360)
Increase (decrease) in current liabilities			
Accounts payable	35,148	(15,446)	2,164
Accrued liabilities	1,296	(338)	1,277
Income taxes payable	7,918	(109)	(4,331)
Turnaround expenditures	–	(18,771)	(7,147)
Other, net	(1,457)	24	141
Net cash provided by operating activities	47,628	38,193	5,457
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase (decrease) in borrowings under credit agreement	(11,600)	11,600	–
Payment of long-term debt	(5,175)	(10,775)	(10,774)
Debt issuance costs	–	(547)	–
Cash dividends	(5,282)	(4,952)	(4,209)
Net cash used for financing activities	(22,057)	(4,674)	(14,983)
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to properties, plants and equipment	(26,903)	(49,715)	(30,304)
Investments and advances to joint ventures	–	(2,000)	(4,087)
Distributions from joint venture	2,924	3,734	–
Investment in equity securities	–	(2,978)	–
Net cash used for investing activities	(23,979)	(50,959)	(34,391)
CASH AND CASH EQUIVALENTS			
Increase (decrease) for the year	1,592	(17,440)	(43,917)
Beginning of year	2,602	20,042	63,959
End of year	$ 4,194	$ 2,602	$ 20,042

See accompanying notes.

CONSOLIDATED STATEMENT OF STOCKHOLDERSÕ EQUITY

($ in thousands)

	Common stock	Additional capital	Retained earnings	Treasury stock	Other comprehensive loss	Total stockholders' equity
Balance at July 31, 1996	$ 87	$6,132	$ 90,593	$ (569)	$ –	$ 96,243
Net income	–	–	13,087	–	–	13,087
Dividends paid	–	–	(4,209)	–	–	(4,209)
Balance at July 31, 1997	87	6,132	99,471	(569)	–	105,121
Net income	–	–	15,167	–	–	15,167
Dividends paid	–	–	(4,952)	–	–	(4,952)
Net unrealized loss on securities available for sale	–	–	–	–	(987)	(987)
Balance at July 31, 1998	87	6,132	109,686	(569)	(987)	114,349
Net income	–	–	19,937	–	–	19,937
Dividends paid	–	–	(5,282)	–	–	(5,282)
Net unrealized loss on securities available for sale	–	–	–	–	(124)	(124)
Balance at July 31, 1999	$ 87	$6,132	$124,341	$ (569)	$ (1,111)	$128,880

See accompanying notes.

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

($ in thousands)

Years ended July 31,	1999	1998	1997
Net income	$ 19,937	$ 15,167	$ 13,087
Other comprehensive income			
Unrealized loss on securities available for sale	(206)	(1,641)	–
Income tax benefit	(82)	(654)	–
	(124)	(987)	–
Total comprehensive income	$ 19,813	$ 14,180	$ 13,087

See accompanying notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

Holly Corporation, and its consolidated subsidiaries, herein referred to as the "Company" unless the context otherwise indicates, is principally an independent petroleum refiner, which produces high value refined products such as gasoline, diesel fuel and jet fuel. Navajo Refining Company ("Navajo"), one of the Company's wholly-owned subsidiaries, owns a high-conversion petroleum refinery in Artesia, New Mexico, which Navajo operates in conjunction with crude, vacuum distillation and other facilities situated 65 miles away in Lovington, New Mexico (collectively, the "Navajo Refinery"). The Navajo Refinery has a crude capacity of 60,000 barrels-per-day ("BPD"), can process a variety of high sulfur (sour) crude oils and serves markets in the southwestern United States and northern Mexico. The Company also owns Montana Refining Company, a Partnership ("MRC"), which owns a 7,000 BPD petroleum refinery near Great Falls, Montana ("Montana Refinery"), which can process a variety of high sulfur crude oils and which primarily serves markets in Montana. In conjunction with its refining operations, the Company operates approximately 1,300 miles of pipelines as part of its supply and distribution network of the refineries. In recent years, the Company has made an effort to develop and expand a pipeline transportation segment which generates revenues from unaffiliated parties. During the fiscal year ended July 31, 1999, the Company realized significant earnings from these transportation operations. The pipeline transportation operations include approximately 900 miles of pipelines, of which approximately 400 miles are also used as part of the supply and distribution network of the Navajo Refinery. Additionally, the Company has a 25% investment in Rio Grande Pipeline Company, which provides petroleum products transportation to northern Mexico. The Company also conducts a small-scale oil and gas exploration and production program and has a small investment in a joint venture operating retail gasoline stations and convenience stores in Montana.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company, its subsidiaries and MRC. All significant intercompany transactions and balances have been eliminated.

USE OF ESTIMATES

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

CASH EQUIVALENTS

For purposes of the statement of cash flows, the Company considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

INVENTORIES

Inventories are stated at the lower of cost, using the last-in, first-out ("LIFO") method for crude oil and refined products and the average cost method for materials and supplies, or market.

INVESTMENTS IN JOINT VENTURES

In fiscal 1996, the Company entered into a joint venture to transport liquid petroleum gas to Mexico. The Company has a 25% interest in the joint venture and accounts for earnings using the equity method. In addition to the cash investment made in fiscal 1997, the Company contributed properties to the joint venture which had a net book value of $734,000 in fiscal 1996 and $227,000 in fiscal 1998.

In fiscal 1998, the Company invested in a joint venture (a limited liability company) to operate retail service stations and convenience stores in Montana. The Company has a 49% interest in the joint venture and accounts for earnings using the equity method. The Company has reserved approximately $700,000 related to the collectability of advances, and related accrued interest, associated with this joint venture.

INVESTMENTS IN EQUITY SECURITIES

Investments in equity securities are classified as available-for-sale and are reported at fair value with unrealized gains or losses, net of tax, recorded as other comprehensive income.

REVENUE RECOGNITION

Refined product sales and related cost of sales are recognized when products are shipped to customers. Pipeline transportation revenues are recognized as products are shipped through Company operated pipelines. Crude oil buy/sell exchanges are customarily used in association with operation of the pipelines, with only the net differential of such transactions reflected as revenues. Additional pipeline transportation revenues result from the lease of an interest in the capacity of a Company operated pipeline, which is recognized over the term of the lease. All revenues are reported exclusive of excise taxes. Intercompany sales are eliminated in consolidation and were insignificant during fiscal 1997-1999.

DEPRECIATION

Depreciation is provided by the straight-line method over the estimated useful lives of the assets, primarily 10 to 16 years for refining and pipeline facilities and 3 to 10 years for corporate and other assets.

TURNAROUND COSTS

Turnarounds consist of preventive maintenance on major processing units as well as the shutdown and restart of all units, and generally are scheduled at three to five year intervals. Turnaround costs are deferred and amortized over the period until the next scheduled turnaround.

ENVIRONMENTAL COSTS

Environmental costs are expensed if they relate to an existing condition caused by past operations and do not contribute to current or future revenue generation. Liabilities are recorded when site restoration and environmental remediation and cleanup obligations are either known or considered probable and can be reasonably estimated. Recoveries of environmental costs through insurance, indemnification arrangements or other sources are included in other assets to the extent such recoveries are considered probable.

OIL AND GAS EXPLORATION AND DEVELOPMENT

The Company accounts for the acquisition, exploration, development and production costs of its oil and gas activities using the successful efforts method of accounting. Lease acquisition costs are capitalized; undeveloped leases are written down when determined to be impaired and written off upon expiration or surrender. Geological and geophysical costs and delay rentals are expensed as incurred. Exploratory well costs are initially capitalized, but if the effort is unsuccessful, the costs are charged against earnings. Development costs, whether or not successful, are capitalized. Productive properties are stated at the lower of amortized cost or estimated realizable value of underlying proved oil and gas reserves. Depreciation, depletion and amortization of such properties is computed by the units-of-production method. At July 31, 1999, the Company did not own a material amount of proven reserves.

INCOME TAXES

Provisions for income taxes include deferred taxes resulting from temporary differences in income for financial and tax purposes, using the liability method of accounting for income taxes. The liability method requires the effect of tax rate changes on current and accumulated deferred income taxes to be reflected in the period in which the rate change was enacted. The liability method also requires that deferred tax assets be reduced by a valuation allowance unless it is more likely than not that the assets will be realized.

STOCK-BASED COMPENSATION

Statement of Financial Accounting Standards (“SFAS”) No. 123, “Accounting for Stock-Based Compensation” encourages companies to adopt a fair value approach to valuing stock options that would require compensation cost to be recognized based on the fair value of stock options granted. The Company has elected, as permitted by the standard, to continue to follow its intrinsic value based method of accounting for stock options consistent with Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock issued to Employees.” Under the intrinsic value method, compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company’s stock at the measurement date over the exercise price.

DERIVATIVE INSTRUMENTS

The Company periodically utilizes petroleum commodity future contracts to reduce its exposure to the price fluctuations associated with crude oil and refined products. Such contracts are used principally to help manage the price risk inherent in purchasing crude oil in advance of the delivery date and as a hedge for fixed-price sales contracts of refined products. Gains and losses on contracts are deferred and recognized in cost of refined products when the related inventory is sold or the hedged transaction is consummated. No such contracts were outstanding at July 31, 1999.

COMPREHENSIVE INCOME

Effective for the fiscal year ended July 31, 1999, the Company adopted SFAS No. 130, “Reporting Comprehensive Income,” which establishes standards for reporting comprehensive income and its components in a full set of general purpose financial statements. A separate consolidated statement of comprehensive income is now included in the accompanying consolidated financial statements. Certain amounts from prior periods have been reclassified to conform with the new requirements of SFAS No. 130.

SEGMENT DISCLOSURES

Effective for the fiscal year ended July 31, 1999, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." This statement establishes new standards for reporting information about operating segments in annual financial statements and selected information about operating segments in interim financial statements issued to stockholders. It also established standards for related disclosures about products and services, geographic areas, and major customers. The Company has identified its segments as "Refining" and "Pipeline Transportation."

PENSIONS AND OTHER POSTRETIREMENT BENEFITS DISCLOSURES

Effective for the fiscal year ended July 31, 1999, the Company adopted SFAS No. 132, "Employers' Disclosures about Pensions and Postretirement Benefits." This statement standardizes the disclosure requirements for pension plans and other postretirement benefits to the extent practicable, requires additional information on changes in the benefit obligations and fair value of plan assets and eliminates certain disclosures under previous standards. Certain amounts from prior periods have been reclassified to conform with the new requirements of SFAS No. 132 and additional information for prior periods has been added.

RECLASSIFICATIONS

Certain reclassifications have been made to the prior years' financial statements to conform to the current presentation.

NEW ACCOUNTING PRONOUNCEMENTS

In June 1998, the Financial Accounting Standards Board ("FASB") issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires that all derivatives be recognized as either assets or liabilities in the statement of financial position and that those instruments be measured at fair value. SFAS No. 133 also prescribes the accounting treatment for changes in the fair value of derivatives which depends on the intended use of the derivative and the resulting designation. Designations include hedges of the exposure to changes in the fair value of a recognized asset or liability, hedges of the exposure to variable cash flows of a forecasted transaction, hedges of the exposure to foreign currency translations, and derivatives not designated as hedging instruments. In June 1999, the FASB issued SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." Under SFAS No. 137, SFAS No. 133 becomes effective for all fiscal quarters of all fiscal years beginning after June 15, 2000 with early adoption permitted. The Company has not completed evaluating the effects this statement will have on its financial reporting and disclosures.

2. EARNINGS PER SHARE

The following is a reconciliation of the numerators and denominators of the basic and diluted per share computations for income:

($ in thousands, except per share amounts)	1999	1998	1997
Net income	$ 19,937	$ 15,167	$ 13,087
Average number of shares of common stock outstanding	8,254	8,254	8,254
Effect of dilutive stock options	–	4	–
Average number of shares of common stock outstanding assuming dilution	8,254	8,258	8,254
Income per share – basic	$ 2.42	$ 1.84	$ 1.59
Income per share – diluted	$ 2.42	$ 1.84	$ 1.59

There were no transactions subsequent to July 31, 1999, which, had the transactions occurred before July 31, 1999, would materially change the number of common shares or potential common shares outstanding as of July 31, 1999.

3. ACCOUNTS RECEIVABLE

($ in thousands)	1999	1998
Product and transportation	$ 47,832	$ 33,346
Crude oil resales	75,670	49,033
	$123,502	$ 82,379

Crude oil resales accounts receivable represent the sell side of reciprocal crude oil buy/sell exchange arrangements, with an approximate like amount reflected in accounts payable. The net differential of these crude oil buy/sell exchanges involved in supplying crude oil to the refineries is reflected in cost of sales, and results principally from crude oil type and location differences. The net differential of crude oil buy/sell exchanges involved in pipeline transportation is reflected in revenue, as the exchanges were entered into as a means to effect pipeline transportation fees.

The majority of the amounts due are from companies in the petroleum industry. Credit is extended based on evaluation of the customer's financial condition and, in certain circumstances, collateral, such as letters of credit or guaranties, is required.

Credit losses are charged to income when accounts are deemed uncollectible and consistently have been minimal.

4. INVENTORIES

($ in thousands)	1999	1998
Crude oil and refined products	$ 47,364	$ 46,754
Materials and supplies	10,553	12,081
	57,917	58,835
Reserve for lower of cost or market	2,993	2,993
	$ 54,924	$ 55,842

The excess of current cost over the LIFO value of inventory was $11,416,000 at July 31, 1999. Current cost approximated the LIFO value of inventory at July 31, 1998.

5. PROPERTIES, PLANTS AND EQUIPMENT

($ in thousands)	1999	1998
Land, buildings and improvements	$ 15,334	$ 11,353
Refining facilities	195,202	188,033
Pipelines and terminals	89,481	71,130
Transportation vehicles	12,648	11,391
Oil and gas exploration and development	21,689	21,749
Other fixed assets	5,481	5,033
Construction in progress	12,344	17,304
	352,179	325,993
Accumulated depreciation, depletion and amortization	171,285	152,696
	$180,894	$173,297

6. DEBT

($ in thousands)	1999	1998
Senior Notes		
Series B	$ 10,333	$ 15,500
Series C	39,000	39,000
Series D	21,000	21,000
Other	8	16
	70,341	75,516
Less current maturities of long-term debt	13,746	5,175
	$ 56,595	$ 70,341

SENIOR NOTES

In June 1991, the Company sold $80 million of Senior Notes to a group of insurance companies. The Series A Notes, which were issued in the principal amount of $28 million, were paid off in full in fiscal 1998. The Series B Notes, which were issued in the principal amount of $52 million, have a 10-year life, require equal annual principal payments beginning June 15, 1996 and bear interest at 10.16%. In November 1995, the Company completed the funding from a group of insurance companies of a new private placement of Senior Notes in the amount of $39 million and the extension of $21 million of previously outstanding Senior Notes. The $39 million Series C Notes have a 10-year life, require equal annual principal payments beginning December 15, 1999, and bear interest at 7.62%. The $21 million Series D Notes, for which previously issued Series B Notes were exchanged, have a 10-year life, require equal annual principal payments beginning December 15, 1999, and bear interest at an initial rate of 10.16%, with reductions to 7.82% for the periods subsequent to the original maturity dates of the exchanged Series B Notes; such rate was 8.60% as of July 31, 1999. The Senior Notes are unsecured and the note agreements impose certain restrictive covenants, including limitations on liens, additional indebtedness, sales of assets, investments, business combinations and dividends, which collectively are less restrictive than the terms of the bank Credit Agreement.

CREDIT AGREEMENT

In October 1997, the Company and its subsidiaries entered into a three-year credit agreement (“Credit Agreement”) with a group of banks. The Credit Agreement provides a $100 million facility for letters of credit or for direct borrowings of up to $50 million. Interest on borrowings is based upon, at the Company’s option, (i) the higher of the agent bank’s prime rate or the Federal funds rate plus .50% per annum; or (ii) a spread over various Euro-dollar related rates. A fee ranging from 1% to 1.5% per annum is payable on the outstanding balance of all letters of credit and a commitment fee ranging from .20% to .35% per annum is payable on the unused portion of the facility. Such fees are determined based on a quarterly calculation of the ratio of cash flow to debt of the Company. The borrowing base, which secures the facility, consists of cash, accounts receivable and inventory. The Credit Agreement imposes certain requirements, including: (i) a prohibition of other indebtedness in excess of $5 million with exceptions for, among other things, indebtedness under the Company’s Senior Notes; (ii) maintenance of certain levels of net worth, working capital and a cash-flow-to-debt ratio; (iii) limitations on investments, capital expenditures and dividends; and (iv) a prohibition of changes in controlling ownership and material changes in senior management.

At July 31, 1999, the Company had outstanding letters of credit totalling $18,110,000, and no borrowings outstanding. The unused commitment under the Credit Agreement at July 31, 1999 was $81,890,000, of which up to $50,000,000 may be used for additional direct borrowings.

The average and maximum amounts outstanding and the effective average interest rate for borrowings under the

Company's current and prior credit agreements were as follows:

($ in thousands)	1999	1998
Average amount outstanding	$ 10,028	$ 2,455
Maximum balance	$ 26,000	$ 23,700
Effective average interest rate	7.9%	8.5%

No borrowings under the Company's previous credit agreement were outstanding during fiscal 1997.

The Senior Notes and Credit Agreement restrict investments and distributions, including dividends. Under the most restrictive of these covenants, at July 31, 1999 approximately $10.6 million was available for the payment of dividends, subject to a maximum of $6 million per fiscal year.

Maturities of long-term debt for the next five fiscal years are as follows: 2000 — $13,746,000; 2001 — $13,738,000; 2002 — $8,571,000; 2003 — $8,571,000 and 2004 — $8,571,000.

The Company made interest payments of $7,555,000 in 1999, $8,239,000 in 1998 and $9,209,000 in 1997.

Based on the borrowing rates that the Company believes would be available for replacement loans with similar terms and maturities of the debt of the Company now outstanding, the Company estimates fair value of long-term debt including current maturities to be $69.3 million at July 31, 1999.

7. INCOME TAXES

The provision for income taxes is comprised of the following:

($ in thousands)	1999	1998	1997
Current			
Federal	$ 10,928	$ 2,589	$ 5,838
State	2,561	532	1,413
Deferred			
Federal	(223)	5,268	1,244
State	(44)	1,310	237
	$ 13,222	$ 9,699	$ 8,732

The statutory federal income tax rate applied to pre-tax book income reconciles to income tax expense as follows:

($ in thousands)	1999	1998	1997
Tax computed at statutory rate	$ 11,606	$ 8,703	$ 7,637
State income taxes, net of federal tax benefit	1,617	1,212	1,064
Other	(1)	(216)	31
	$ 13,222	$ 9,699	$ 8,732

Prior to the acquisition of MRC by the Company, operations of the corporation that was the sole limited partner of MRC resulted in unused net operating loss carryforwards of approximately $9,000,000, which are expected to be available to the Company to a limited extent each year through 2006 based on the income of MRC. As of July 31, 1999, approximately $3,700,000 of these net operating loss carryforwards remain available to offset future income. For financial reporting purposes, the benefit of these net operating loss carryforwards is being offset against contingent future payments of up to $95,000 per year through 2005 relating to the acquisition of such corporation.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. The Company's deferred income tax assets and liabilities as of July 31, 1999 and 1998 are as follows:

($ in thousands)	1999		
	Assets	Liabilities	Total
Deferred taxes			
Accrued employee benefits	$ 2,573	$ –	$ 2,573
Inventory valuation reserve	1,193	–	1,193
Deferred turnaround costs	–	(2,532)	(2,532)
Pipeline lease	779	–	779
Prepayments and other	169	(1,908)	(1,739)
Total current	4,714	(4,440)	274
Properties, plants and equipment (due primarily to tax in excess of book depreciation)	–	(22,059)	(22,059)
Intangible drilling costs	–	(232)	(232)
Deferred oil and gas costs	1,134	–	1,134
Deferred turnaround costs	–	(2,917)	(2,917)
Investments in equity securities	736	–	736
Earnings of joint ventures	–	(1,104)	(1,104)
Other	407	(545)	(138)
Total noncurrent	2,277	(26,857)	(24,580)
Total	$ 6,991	$ (31,297)	$ (24,306)

($ in thousands)	1998		
	Assets	Liabilities	Total
Deferred taxes			
Accrued employee benefits	$ 1,836	$ –	$ 1,836
Inventory valuation reserve	1,193	–	1,193
Deferred turnaround costs	–	(2,594)	(2,594)
Pipeline lease	470	–	470
Prepayments and other	1,886	(1,873)	13
Total current	5,385	(4,467)	918
Properties, plants and equipment (due primarily to tax in excess of book depreciation)	–	(20,784)	(20,784)
Intangible drilling costs	–	(720)	(720)
Deferred oil and gas costs	1,590	–	1,590
Deferred turnaround costs	–	(5,509)	(5,509)
Investments in equity securities	654	–	654
Earnings of joint ventures	–	(559)	(559)
Other	151	(396)	(245)
Total noncurrent	2,395	(27,968)	(25,573)
Total	$ 7,780	$ (32,435)	$ (24,655)

The Company made income tax payments of $4,816,000 in 1999, $646,000 in 1998 and $9,679,000 in 1997.

8. STOCK OPTION PLAN

The Company has a stock option plan under which certain officers and employees have been granted options. All of the options have been granted at prices equal to the market value of the shares at the time of grant and expire on the tenth anniversary of the grant date. The options are subject to forfeiture with vesting for all options outstanding at July 31, 1999 of 20% at the time of grant and 20% in each of the four years thereafter. At July 31, 1999 and 1998, 751,500 shares of common stock were reserved for issuance under the stock option plan.

The following summarizes stock option transactions:

	Shares	Weighted Average Exercise Price
Balance at July 31, 1996	–	$ –
Granted	25,000	25.50
Balance at July 31, 1997	25,000	25.50
Granted	340,000	26.75
Balance at July 31, 1998	365,000	26.67
Forfeited	(25,000)	25.50
Balance at July 31, 1999	340,000	$ 26.75
Options exercisable at July 31:		
1999	136,000	$ 26.75
1998	76,333	$ 26.61
1997	–	$ –

The following summarizes information about stock options outstanding at July 31, 1999:

Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
340,000	8.6	$ 26.75

As required by SFAS No. 123, the Company has determined the pro-forma information as if it had accounted for stock options granted under the fair value method of SFAS No. 123. The weighted-average fair value of options granted in fiscal 1998 and 1997 was $6.02 and $6.80 per share, respectively. The Black-Scholes option pricing model was used to estimate the fair value of the options at the respective grant date with the following weighted-average assumptions:

	1998	1997
Risk-free interest rates	5.7%	6.4%
Dividend yield	2.2%	1.9%
Expected common stock market price volatility factor	17.2%	18.9%
Weighted-average expected life of options	6 years	6 years

The pro-forma effect of these options on net income and basic and diluted income per share is as follows:

($ in thousands, except per share amounts)	1999	1998	1997
Net income			
As reported	$ 19,937	$ 15,167	$ 13,087
Pro forma	$ 19,638	$ 14,991	$ 13,069
Net income per share (basic and diluted)			
As reported	$ 2.42	$ 1.84	$ 1.59
Pro forma	$ 2.38	$ 1.82	$ 1.58

9. RETIREMENT PLANS

RETIREMENT PLAN

The Company has a non-contributory defined benefit retirement plan that covers substantially all employees. The Company's policy is to make contributions annually of not less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974. Benefits are based on the employee's years of service and compensation.

The following table sets forth the changes in the benefit obligation and plan assets of the Company's retirement plan for the years ended July 31, 1999 and 1998:

($ in thousands)	1999	1998
Change in plan's benefit obligation		
Pension plan's benefit obligation – beginning of year	$ 33,867	$ 29,355
Service cost	1,605	1,257
Interest cost	2,343	2,267
Benefits paid	(1,337)	(1,714)
Actuarial (gain) loss	(2,517)	2,702
Pension plan's benefit obligation – end of year	33,961	33,867
Change in pension plan assets		
Fair value of plan assets – beginning of year	37,818	35,807
Actual return on plan assets	3,907	2,186
Benefits paid	(1,337)	(1,714)
Employer contribution	–	1,539
Fair value of plan assets – end of year	40,388	37,818
Reconciliation of funded status		
Funded status	6,427	3,951
Unrecognized net gain	(7,654)	(4,424)
Unrecognized transition net asset	(371)	(584)
Accrued pension liability recognized on the consolidated balance sheet	$ (1,598)	$ (1,057)

Net periodic pension expense consisted of the following components:

($ in thousands)	1999	1998	1997
Service cost – benefit earned during the year	$ 1,605	$ 1,257	$ 1,170
Interest cost on projected benefit obligations	2,343	2,267	2,087
Expected return on plan assets	(3,164)	(2,996)	(2,415)
Amortization of prior service costs	–	–	36
Recognized actuarial gain	(29)	(290)	–
Amortization of transition asset	(213)	(213)	(213)
Net periodic pension expense	$ 542	$ 25	$ 665

The principal actuarial assumptions as of July 31 were:

	1999	1998	1997
Discount rate	7.5%	7%	7.5%
Rate of future compensation increases	5%	5%	5%
Expected long-term rate of return on assets	8.5%	8.5%	8.5%

Pension costs are determined using the assumptions as of the beginning of the year. The funded status is determined using the assumptions as of the end of the year.

At July 31, 1999, approximately 68% of plan assets is invested in equity securities and 32% is invested in fixed income securities and other instruments.

RETIREMENT RESTORATION PLAN

The Company has adopted an unfunded retirement restoration plan that provides for additional payments from the Company so that total retirement plan benefits for certain executives will be maintained at the levels provided in the retirement plan before the application of Internal Revenue Code limitations. The Company accrued $320,000 in 1999, $297,000 in 1998 and $265,000 in 1997 in connection with this plan. The accrued liability recognized in the consolidated balance sheet was $1,555,000 at July 31, 1999 and $1,330,000 at July 31, 1998.

DEFINED CONTRIBUTION PLANS

The Company has defined contribution ("401(k)") plans that cover substantially all employees. Company contributions are based on employee's compensation and partially match employee contributions. The Company has expensed $1,160,000 in 1999, $1,058,000 in 1998 and $1,058,000 in 1997 in connection with these plans.

10. LEASE COMMITMENTS

The Company leases certain facilities, pipelines and equipment under operating leases, most of which contain renewal options. At July 31, 1999, the minimum future rental commitments under operating leases having noncancellable lease terms in excess of one year total in the aggregate $45,784,000, of which the following amounts are payable over the next five years: 2000 — $6,129,000; 2001 — $6,283,000; 2002 — $6,151,000; 2003 — $5,866,000 and 2004 — $5,499,000. Rental expense charged to operations was $7,165,000 in fiscal 1999, $7,165,000 in fiscal 1998 and was not significant in fiscal 1997.

11. CONTINGENCIES

In August 1998, a lawsuit (the "Longhorn Suit") was filed in state district court in El Paso, Texas against the Company and two of its subsidiaries (along with an Austin, Texas law firm which was subsequently dropped from the case). The suit was filed by Longhorn Partners Pipeline, L.P. ("Longhorn Partners"), a Delaware limited partnership composed of Longhorn Partners GP, L.L.C. as general partner and affiliates of Exxon Pipeline Company, Amoco Pipeline Company, Williams Pipeline Company, and the Beacon Group Energy Investment Fund, L.P. as well as Chisholm Holdings as limited partners. The suit, as amended by Longhorn Partners in March 1999, seeks damages alleged to total up to $1,050,000,000 (after trebling) based on claims of violations of the Texas Free Enterprise and Antitrust Act, unlawful interference with existing and prospective contractual relations, and conspiracy to abuse process. The specific action of the Company complained of in the Longhorn Suit is the support of lawsuits brought by ranchers in West Texas to challenge the proposed refined products pipeline's use of easements and rights-of-way that were granted over 50 years ago for a crude oil pipeline. In mid-July 1999, the state district court in El Paso denied a motion filed by the Company to transfer the venue of the suit to a state district court in Dallas, Texas. The Company believes that the Longhorn Suit is wholly without merit and plans to defend itself vigorously. The Company also plans to pursue at the appropriate time any affirmative remedies that may be available to it relating to the Longhorn Suit.

In December 1998, the Company completed the settlement of a suit filed in July 1993 by the United States Department of Justice ("DOJ"), on behalf of the United States Environmental Protection Agency ("EPA"), against the Company's subsidiary, Navajo Refining Company ("Navajo") alleging wastewater violations at the Navajo Refinery. Under the settlement agreement among Navajo, the DOJ and the State of New Mexico, the Company has paid a civil penalty in December 1998 of less than $2 million, which was reserved for in fiscal 1993, and was required by September 1999 to cease discharge to the existing evaporation ponds of its wastewater treatment system and to utilize an alternative wastewater treatment system. The alternate wastewater system is now being used and closure of the ponds will commence upon approval of the Company's closure plan.

The Company is a party to various other litigation and proceedings which it believes, based on advice of counsel, will not have a materially adverse impact on the Company's financial condition or results of operations.

12. SEGMENT INFORMATION

The Company has two major business segments: Refining and Pipeline Transportation. The Refining segment is engaged in the refining of crude oil and wholesale marketing of refined products, such as gasoline, diesel fuel and jet fuel, and includes the Company's Navajo Refinery and Montana Refinery. The petroleum products produced by the Refining segment are marketed in the southwestern United States, Montana and northern Mexico. Certain pipelines and terminals operate in conjunction with the Refining segment as part of the supply and distribution networks of the refineries. The Pipeline Transportation segment includes approximately 900 miles of the Company's pipeline assets in Texas and New Mexico. Revenues from the Pipeline Transportation segment are earned through transactions with unaffiliated parties for pipeline transportation, rental and terminalling operations. The Pipeline Transportation segment also includes the equity earnings from the Company's 25% investment in Rio Grande Pipeline Company, which provides petroleum products transportation. Operations of the Company that are not included in the two reportable segments are included in Corporate and other, which includes costs of Holly Corporation, the parent company, consisting primarily of general and administrative expenses and interest charges, as well as a small-scale oil and gas exploration and production program and a small equity investment in retail gasoline stations and convenience stores.

The accounting policies for the segments are the same as those described in the summary of significant accounting policies. The Company evaluates performance based on earnings before interest, taxes and depreciation and amortization (EBITDA). The Company's reportable segments are strategic business units that offer different products and services.

($ in thousands)	Refining	Pipeline Transportation	Total for Reportable Segments	Corporate & Other	Consolidated Total
1999					
Sales and other operating revenues	$582,172	$ 11,936	$594,108	$ 3,878	$597,986
EBITDA	$ 63,685	$ 9,881	$ 73,566	$ (6,270)	$ 67,296
Income (loss) from operations	$ 42,118	$ 6,552	$ 48,670	$ (9,697)	$ 38,973
Income (loss) before income taxes	$ 41,760	$ 8,859	$ 50,619	$ (17,460)	$ 33,159
Total assets	$360,111	$ 21,559	$381,670	$ 9,312	$390,982
1998					
Sales and other operating revenues	$582,277	$ 695	$582,972	$ 7,327	$590,299
EBITDA	$ 56,973	$ 2,140	$ 59,113	$ (2,143)	$ 56,970
Income (loss) from operations	$ 38,290	$ 302	$ 38,592	$ (5,827)	$ 32,765
Income (loss) before income taxes	$ 37,872	$ 2,068	$ 39,940	$ (15,074)	$ 24,866
Total assets	$318,825	$ 16,386	$335,211	$ 14,646	$349,857
1997					
Sales and other operating revenues	$715,023	$ –	$715,023	$ 6,323	$721,346
EBITDA	$ 49,078	$ 414	$ 49,492	$ (1,425)	$ 48,067
Income (loss) from operations	$ 33,877	$ –	$ 33,877	$ (6,377)	$ 27,500
Income (loss) before income taxes	$ 33,315	$ 414	$ 33,729	$ (11,910)	$ 21,819
Total assets	$315,677	$ 5,235	$320,912	$ 28,891	$349,803

13. SIGNIFICANT CUSTOMERS

All revenues were domestic revenues, except for sales of gasoline and diesel fuel for export into Mexico by the Refining segment. The export sales were to an affiliate of PEMEX (the government-owned energy company of Mexico) and accounted for approximately $57,000,000 (10%) of the Company's revenues for fiscal 1999, $53,000,000 (9%) of revenues for fiscal 1998 and $71,000,000 (10%) of revenues for fiscal 1997. Sales of military jet fuel to the United States Government by the Refining segment accounted for approximately $56,000,000 (9%) of the Company's revenues for fiscal 1999, $56,000,000 (10%) of revenues for fiscal 1998 and $74,000,000 (10%) of revenues for fiscal 1997. In addition to the United States Government and PEMEX, other significant sales by the Refining segment were made to two petroleum companies, one of which accounted for approximately $92,000,000 (15%) of the Company's revenues in fiscal 1999, $102,000,000 (17%) of the revenues for fiscal 1998 and $156,000,000 (22%) of the revenues in fiscal 1997, and the other accounted for $76,000,000 (13%) of the Company's revenues in fiscal 1999. The Company believes a loss of, or reduction in amounts purchased by, major purchasers that resell to retail customers would not have a material adverse effect on the Company, since the Company's sales volumes with respect to products whose end-users are retail customers appear to have been historically more dependent on general retail demand and product supply in the Company's primary markets than on sales to any specific purchaser and therefore the impact of such a loss on the Company's results of operations should be limited.

14. TRANSACTION COSTS OF TERMINATED MERGER

On September 1, 1998, the Company and Giant Industries, Inc. mutually agreed to terminate their proposed merger, which had been approved by the stockholders of both companies in late June 1998. The decision to terminate the merger was made as a result of the filing of the Longhorn Suit, and as a result of continuing delays and uncertainties in negotiations with the Federal Trade Commission and the State of New Mexico Attorney General's Office concerning federal and state approval of the merger. Merger related transaction costs of $1,940,000 were charged to expense in fiscal 1998.

15. QUARTERLY INFORMATION *(Unaudited)*

FINANCIAL DATA *($ in thousands, except per share amounts)*

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1999					
Sales and other revenues	$142,995	$120,684	$143,375	$190,932	$597,986
Operating costs and expenses	$137,217	$122,449	$126,915	$172,432	$559,013
Income (loss) from operations	$5,778	$(1,765)	$16,460	$18,500	$38,973
Income (loss) before income taxes	$4,291	$(2,962)	$14,668	$17,162	$33,159
Net income (loss)	$2,618	$(1,807)	$8,787	$10,339	$19,937
Net income (loss) per common share (basic and diluted)	$.32	$(.22)	$1.06	$1.26	$2.42
Dividends per common share	$.16	$.16	$.16	$.16	$.64
Average number of shares of common stock outstanding (in thousands)	8,254	8,254	8,254	8,254	8,254
1998					
Sales and other revenues	$168,922	$136,783	$134,208	$150,386	$590,299
Operating costs and expenses	$158,848	$136,979	$126,584	$135,123	$557,534
Income (loss) from operations	$10,074	$(196)	$7,624	$15,263	$32,765
Income (loss) before income taxes	$8,679	$(1,634)	$5,250	$12,571	$24,866
Net income (loss)	$5,207	$(980)	$2,973	$7,967	$15,167
Net income (loss) per common share (basic and diluted)	$.63	$(.12)	$.36	$.97	$1.84
Dividends per common share	$.15	$.15	$.15	$.15	$.60
Average number of shares of common stock outstanding (in thousands)	8,254	8,254	8,254	8,254	8,254

OPERATING DATA *(barrels-per-day)*

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1999					
Sales of refined products	77,200	72,300	72,800	79,000	75,400
Refinery production	71,200	70,000	69,200	72,300	70,700
1998					
Sales of refined products	65,000	59,000	70,100	76,700	67,700
Refinery production	50,200	58,400	68,600	70,400	61,800

BOARD OF DIRECTORS

Seated left to right

Jack P. Reid (1)
Consultant to the Company and former Executive Vice President

Lamar Norsworthy (1)
Chairman of the Board and Chief Executive Officer of the Company

Matthew P. Clifton (1)
President of the Company

Standing left to right

Marcus R. Hickerson (2)
Consultant to Centex Development Company, a subsidiary of Centex Corporation

Robert G. McKenzie (2)
Consultant to Brown Brothers Harriman Trust Company of Texas

Thomas K. Matthews, II (2)
Financial Consultant

A. J. Losee (1)(2)
Attorney, Counsel to the law firm of Losee, Carson, Haas & Carroll, P.A.

William J. Gray
Consultant to the Company and former Senior Vice President

Not pictured

W. John Glancy
Senior Vice President, General Counsel and Secretary

(1) *Member of the Executive Committee of the Board of Directors*

(2) *Member of the Audit Committee, Compensation Committee and the Public Policy Committee of the Board of Directors*

OFFICERS

Lamar Norsworthy
Chairman of the Board and Chief Executive Officer

Matthew P. Clifton
President

W. John Glancy
Senior Vice President, General Counsel and Secretary

David F. Chavenson
Vice President and Chief Financial Officer

David G. Blair
Vice President, Marketing Asphalt and LPG

Leland J. M. Griffin
Vice President, Montana Operations

Randall R. Howes
Vice President, Engineering and Economics

John A. Knorr
Vice President, Crude Oil Supply and Trading

Virgil R. Langford
Vice President, Refining

Mike Mirbagheri
Vice President, International Crude Oil and Refined Products

Henry A. Teichholz
Vice President

James G. Townsend
Vice President, Pipelines and Terminals

Kathryn H. Walker
Vice President, Accounting

Gregory A. White
Vice President, Marketing Light Oils

CORPORATE DATA

CORPORATE OFFICE
Holly Corporation
100 Crescent Court
Suite 1600
Dallas, Texas 75201-6927
(214) 871-3555
www.hollycorp.com

REFINERIES
Navajo Refining Company
501 East Main
Artesia, New Mexico 88210
(505) 748-3311

Montana Refining Company
1900 10th Street
Black Eagle, Montana 59414
(406) 761-4100

AUDITORS
Ernst & Young LLP
Dallas, Texas

STOCK TRANSFER AGENT AND REGISTRAR
BankBoston, N.A.
c/o EquiServe
P. O. Box 8040
Boston, MA 02266-8040
(800) 730-6001
www.equiserve.com

Correspondence or questions concerning share holdings, transfers, lost certificates, dividends, or address or registration changes should be directed to EquiServe.

STOCK EXCHANGE LISTING
American Stock Exchange
Ticker Symbol: HOC

ANNUAL MEETING
The annual stockholders' meeting will be held at 9:30 A.M. on December 9, 1999, in Suite 200, 303 West Main, Artesia, New Mexico.

FORM 10-K
The Company's Form 10-K Annual Report to the Securities and Exchange Commission is available to stockholders upon written request to Mr. Gerard L. Regard at Holly Corporation headquarters in Dallas.

HOLLY
CORPORATION

100 CRESCENT COURT
SUITE 1600
DALLAS, TEXAS 75201-6927

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