

HOLLY ENERGY PARTNERS LP  
Form 10-Q  
May 06, 2015

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

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FORM 10-Q

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(Mark One)

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

For the quarterly period ended March 31, 2015

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-32225

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HOLLY ENERGY PARTNERS, L.P.

(Exact name of registrant as specified in its charter)

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Delaware (State or other jurisdiction of incorporation or organization)	20-0833098 (I.R.S. Employer Identification No.)
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2828 N. Harwood, Suite 1300 Dallas, Texas (Address of principal executive offices) (214) 871-3555 (Registrant's telephone number, including area code)	75201 (Zip code)
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(Former name, former address and former fiscal year, if changed since last report)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

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Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined by Rule 12b-2 of the Exchange Act). Yes  No

The number of the registrant's outstanding common units at April 30, 2015 was 58,657,048.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains certain “forward-looking statements” within the meaning of the federal securities laws. All statements, other than statements of historical fact included in this Form 10-Q, including, but not limited to, those under “Results of Operations” and “Liquidity and Capital Resources” in Item 2 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in Part I are forward-looking statements.

Forward-looking statements use words such as “anticipate,” “project,” “expect,” “plan,” “goal,” “forecast,” “intend,” “should,” “could,” “believe,” “may,” and similar expressions and statements regarding our plans and objectives for future operations.

These statements are based on our beliefs and assumptions and those of our general partner using currently available information and expectations as of the date hereof, are not guarantees of future performance and involve certain risks and uncertainties. Although we and our general partner believe that such expectations reflected in such forward-looking statements are reasonable, neither we nor our general partner can give assurance that our expectations will prove to be correct. All statements concerning our expectations for future results of operations are based on forecasts for our existing operations and do not include the potential impact of any future acquisitions. Our forward-looking statements are subject to a variety of risks, uncertainties and assumptions. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, our actual results may vary materially from those anticipated, estimated, projected or expected. Certain factors could cause actual results to differ materially from results anticipated in the forward-looking statements. These factors include, but are not limited to:

- risks and uncertainties with respect to the actual quantities of petroleum products and crude oil shipped on our pipelines and/or terminalled, stored or throughput in our terminals;
- the economic viability of HollyFrontier Corporation, Alon USA, Inc. and our other customers;
- the demand for refined petroleum products in markets we serve;
- our ability to purchase and integrate future acquired operations;
- our ability to complete previously announced or contemplated acquisitions;
- the availability and cost of additional debt and equity financing;
- the possibility of reductions in production or shutdowns at refineries utilizing our pipeline and terminal facilities;
- the effects of current and future government regulations and policies;
- our operational efficiency in carrying out routine operations and capital construction projects;
- the possibility of terrorist attacks and the consequences of any such attacks;
- general economic conditions; and
- other financial, operational and legal risks and uncertainties detailed from time to time in our Securities and Exchange Commission filings.

Cautionary statements identifying important factors that could cause actual results to differ materially from our expectations are set forth in this Form 10-Q, including without limitation, the forward-looking statements that are referred to above. When considering forward-looking statements, you should keep in mind the known material risk factors and other cautionary statements set forth in our Annual Report on Form 10-K for the year ended December 31, 2014, in “Risk Factors” and in this Form 10-Q in “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” All forward-looking statements included in this Form 10-Q and all subsequent written or oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. The forward-looking statements speak only as of the date made and, other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

HOLLY ENERGY PARTNERS, L.P.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except unit data)

	March 31, 2015 (Unaudited)	December 31, 2014
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$5,802	\$2,830
Accounts receivable:		
Trade	11,837	6,737
Affiliates	28,018	33,392
	39,855	40,129
Prepaid and other current assets	4,389	4,383
Total current assets	50,046	47,342
Properties and equipment, net	1,003,988	980,479
Transportation agreements, net	78,967	80,703
Goodwill	256,498	256,498
Investment in SLC Pipeline	24,462	24,478
Other assets	10,638	12,055
Total assets	\$1,424,599	\$1,401,555
<b>LIABILITIES AND PARTNERS' EQUITY</b>		
Current liabilities:		
Accounts payable:		
Trade	\$12,689	\$12,642
Affiliates	15,803	5,239
	28,492	17,881
Accrued interest	1,804	6,615
Deferred revenue	7,819	12,432
Accrued property taxes	2,745	2,703
Other current liabilities	4,402	4,571
Total current liabilities	45,262	44,202
Long-term debt	890,742	867,579
Other long-term liabilities	22,093	18,145
Deferred revenue	30,649	29,392
Class B unit	28,534	26,793
Equity:		
Partners' equity:		

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Common unitholders (58,657,048 units issued and outstanding at March 31, 2015 and December 31, 2014)	460,405	468,813
General partner interest (2% interest)	(148,410	) (148,405 )
Accumulated other comprehensive loss	(795	) (46 )
Total partners' equity	311,200	320,362
Noncontrolling interest	96,119	95,082
Total equity	407,319	415,444
Total liabilities and equity	\$1,424,599	\$1,401,555

See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.  
CONSOLIDATED STATEMENTS OF INCOME  
(Unaudited)  
(In thousands, except per unit data)

	Three Months Ended March 31,	
	2015	2014
Revenues:		
Affiliates	\$72,255	\$71,832
Third parties	17,501	15,172
	89,756	87,004
Operating costs and expenses:		
Operations (exclusive of depreciation and amortization)	27,966	22,812
Depreciation and amortization	14,694	15,588
General and administrative	3,290	3,151
	45,950	41,551
Operating income	43,806	45,453
Other income (expense):		
Equity in earnings of SLC Pipeline	734	522
Interest expense	(8,768	) (10,454
Interest income	—	3
Loss on early extinguishment of debt	—	(7,677
Other income	159	8
	(7,875	) (17,598
Income before income taxes	35,931	27,855
State income tax expense	(101	) (75
Net income	35,830	27,780
Allocation of net income attributable to noncontrolling interests	(4,027	) (3,637
Net income attributable to Holly Energy Partners	31,803	24,143
General partner interest in net income, including incentive distributions	(9,810	) (8,001
Limited partners' interest in net income	\$21,993	\$16,142
Limited partners' per unit interest in earnings—basic and diluted	\$0.37	\$0.27
Weighted average limited partners' units outstanding	58,657	58,657

See accompanying notes.

HOLLY ENERGY PARTNERS, L.P.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited)  
(In thousands)

	Three Months Ended March 31,	
	2015	2014
Net income	\$35,830	\$27,780
Other comprehensive income:		
Change in fair value of cash flow hedging instruments	(1,280)	(443)
Reclassification adjustment to net income on partial settlement of cash flow hedge	531	538
Other comprehensive income (loss)	(749)	95
Comprehensive income before noncontrolling interest	35,081	27,875
Allocation of comprehensive income to noncontrolling interests	(4,027)	(3,637)
Comprehensive income attributable to Holly Energy Partners	\$31,054	\$24,238

See accompanying notes.



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HOLLY ENERGY PARTNERS, L.P.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(Unaudited)  
(In thousands)

	Three Months Ended March 31,	
	2015	2014
Cash flows from operating activities		
Net income	\$35,830	\$27,780
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	14,694	15,588
Gain on sale of assets	(159)	)
Amortization of deferred charges	436	511
Amortization of restricted and performance units	896	820
Loss on early extinguishment of debt	—	7,677
(Increase) decrease in operating assets:		
Accounts receivable—trade	(5,065)	) (302
Accounts receivable—affiliates	5,804	615
Prepaid and other current assets	39	374
Increase (decrease) in operating liabilities:		
Accounts payable—trade	1,748	2,568
Accounts payable—affiliates	10,564	(3,894
Accrued interest	(4,811)	) (8,463
Deferred revenue	(3,355)	) (4,857
Accrued property taxes	42	725
Other current liabilities	57	304
Other, net	4,171	(430
Net cash provided by operating activities	60,891	39,016
Cash flows from investing activities		
Additions to properties and equipment	(11,291)	) (20,604
Purchase of El Dorado crude tanks	(27,500)	) —
Proceeds from sale of assets	218	—
Distributions in excess of equity in earnings of SLC Pipeline	16	40
Net cash used for investing activities	(38,557)	) (20,564
Cash flows from financing activities		
Borrowings under credit agreement	153,500	421,300
Repayments of credit agreement borrowings	(130,500)	) (246,600
Redemption of senior notes	—	(156,188
Distributions to HEP unitholders	(40,865)	) (37,342
Distributions to noncontrolling interest	(1,250)	) (750
Purchase of units for incentive grants	(247)	) (336
Other	—	(9
Net cash used by financing activities	(19,362)	) (19,925
Cash and cash equivalents		
Increase (decrease) for the period	2,972	(1,473

Beginning of period	2,830	6,352
End of period	\$5,802	\$4,879

See accompanying notes.

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HOLLY ENERGY PARTNERS, L.P.  
CONSOLIDATED STATEMENTS OF PARTNERS' EQUITY  
(Unaudited)  
(In thousands)

	Common Units	General Partner Interest	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Total Equity
Balance December 31, 2014	\$468,813	\$(148,405)	\$(46 )	\$95,082	\$415,444
Distributions to HEP unitholders	(31,084 )	(9,781 )	—	—	(40,865 )
Distributions to noncontrolling interest	—	—	—	(1,250 )	(1,250 )
Purchase of units for incentive grants	(247 )	—	—	—	(247 )
Amortization of restricted and performance units	896	—	—	—	896
Class B unit accretion	(1,706 )	(34 )	—	—	(1,740 )
Net income	23,733	9,810	—	2,287	35,830
Other comprehensive loss	—	—	(749 )	—	(749 )
Balance March 31, 2015	\$460,405	\$(148,410)	\$(795 )	\$96,119	\$407,319

See accompanying notes.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1: Description of Business and Presentation of Financial Statements

Holly Energy Partners, L.P. (“HEP”), together with its consolidated subsidiaries, is a publicly held master limited partnership which is 39% owned (including the 2% general partner interest) by HollyFrontier Corporation (“HFC”) and its subsidiaries. We commenced operations on July 13, 2004, upon the completion of our initial public offering. In these consolidated financial statements, the words “we,” “our,” “ours” and “us” refer to HEP unless the context otherwise indicates.

We operate in one reportable segment which represents the aggregation of our petroleum product and crude pipelines business and terminals, tankage and loading rack facilities operation.

We own and operate petroleum product and crude oil pipelines and terminal, tankage and loading rack facilities that support HFC’s refining and marketing operations in the Mid-Continent, Southwest and Rocky Mountain regions of the United States and Alon USA, Inc.’s (“Alon”) refinery in Big Spring, Texas. Additionally, we own a 75% interest in UNEV Pipeline, LLC (“UNEV”), which owns a 427-mile, 12-inch refined products pipeline running from Woods Cross, Utah to Las Vegas, Nevada (the “UNEV Pipeline”), product terminals near Cedar City, Utah and Las Vegas, Nevada and related assets, and a 25% interest in SLC Pipeline LLC, which owns a 95-mile intrastate crude oil pipeline system (the “SLC Pipeline”) that serves refineries in the Salt Lake City, Utah area.

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

The consolidated financial statements included herein have been prepared without audit, pursuant to the rules and regulations of the United States Securities and Exchange Commission (the “SEC”). The interim financial statements reflect all adjustments, which, in the opinion of management, are necessary for a fair presentation of our results for the interim periods. Such adjustments are considered to be of a normal recurring nature. Although certain notes and other information required by U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted, we believe that the disclosures in these consolidated financial statements are adequate to make the information presented not misleading. These consolidated financial statements should be read in conjunction with our Form 10-K for the year ended December 31, 2014. Results of operations for interim periods are not necessarily indicative of the results of operations that will be realized for the year ending December 31, 2015.

New Accounting Pronouncements

Revenue Recognition

In May 2014, an accounting standard update was issued requiring revenue to be recognized when promised goods or services are transferred to customers in an amount that reflects the expected consideration for these goods or services. This standard has a proposed effective date of January 1, 2018. We are evaluating the impact of this standard.

Debt Issuance Costs

In April 2015, an accounting standard update was issued requiring debt issuance costs to be presented as a direct deduction from the carrying amount of the debt liability. The amount of deferred debt issuance costs reported in Long-term assets was \$4.1 million and \$4.4 million as of March 31, 2015 and December 31, 2014, respectively. This standard will become effective beginning with our 2016 reporting year.

Note 2: Financial Instruments

Our financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable, debt and interest rate swaps. The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term maturity of these instruments. Debt consists of outstanding principal under our revolving credit agreement (which approximates fair value as interest rates are reset frequently at current interest rates) and our fixed interest rate senior notes.

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

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

Level 1) Quoted prices in active markets for identical assets or liabilities.

Level 2) Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets, similar assets and liabilities in markets that are not active or can be corroborated by observable market data.

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

The carrying amounts and estimated fair values of our senior notes and interest rate swaps were as follows:

Financial Instrument	Fair Value Input Level	March 31, 2015		December 31, 2014	
		Carrying Value (In thousands)	Fair Value	Carrying Value	Fair Value
<b>Assets:</b>					
Interest rate swaps	Level 2	\$ 147	\$ 147	\$ 1,019	\$ 1,019
<b>Liabilities:</b>					
6.5% Senior notes	Level 2	\$ 296,742	\$ 295,500	\$ 296,579	\$ 291,000
Interest rate swaps	Level 2	942	942	1,065	1,065
		\$ 297,684	\$ 296,442	\$ 297,644	\$ 292,065

#### Level 2 Financial Instruments

Our senior notes and interest rate swaps are measured at fair value using Level 2 inputs. The fair value of the senior notes is based on market values provided by a third-party bank, which were derived using market quotes for similar type debt instruments. The fair value of our interest rate swaps is based on the net present value of expected future cash flows related to both variable and fixed-rate legs of the swap agreement. This measurement is computed using the forward London Interbank Offered Rate ("LIBOR") yield curve, a market-based observable input.

See Note 6 for additional information on these instruments.

#### Note 3: Properties and Equipment

The carrying amounts of our properties and equipment are as follows:

	March 31, 2015 (In thousands)	December 31, 2014
Pipelines, terminals and tankage	\$ 1,169,685	\$ 1,137,157
Land and right of way	64,497	64,458
Construction in progress	59,701	56,228
Other	22,501	22,636
	1,316,384	1,280,479
Less accumulated depreciation	312,396	300,000
	\$ 1,003,988	\$ 980,479

On March 6, 2015, we completed the acquisition of an existing crude tank farm adjacent to HFC's El Dorado Refinery from an unrelated third-party for \$27.5 million in cash. We recorded the assets acquired and liabilities assumed at their fair values at the date of acquisition based on preliminary valuations. Substantially all of the purchase price was allocated to properties and equipment. No goodwill was recorded. We expect to finalize the purchase price allocation during the second quarter of 2015. HFC is the main customer of this crude tank farm.

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

We capitalized \$0.3 million and \$0.4 million in interest attributable to construction projects during the three months ended March 31, 2015 and 2014, respectively.

Depreciation expense was \$12.8 million and \$13.7 million for the three months ended March 31, 2015 and 2014, respectively.

Note 4: Transportation Agreements

Our transportation agreements represent a portion of the total purchase price of certain assets acquired from Alon in 2005 and from HFC in 2008. The Alon agreement is being amortized over 30 years ending 2035 (the initial 15-year term of the agreement plus an expected 15-year extension period), and the HFC agreement is being amortized over 15 years ending 2023 (the term of the HFC agreement).

The carrying amounts of our transportation agreements are as follows:

	March 31, 2015	December 31, 2014
	(In thousands)	
Alon transportation agreement	\$59,933	\$59,933
HFC transportation agreement	74,231	74,231
	134,164	134,164
Less accumulated amortization	55,197	53,461
	\$78,967	\$80,703

We have additional transportation agreements with HFC resulting from historical transactions consisting of pipeline, terminal and tankage assets contributed to us or acquired from HFC. These transactions occurred while we were a consolidated variable interest entity of HFC; therefore, our basis in these agreements is zero and does not reflect a step-up in basis to fair value.

Note 5: Employees, Retirement and Incentive Plans

Direct support for our operations is provided by Holly Logistic Services, L.L.C., an HFC subsidiary, which utilizes personnel employed by HFC who are dedicated to performing services for us. Their costs, including salaries, bonuses, payroll taxes, benefits and other direct costs, are charged to us monthly in accordance with an omnibus agreement that we have with HFC. These employees participate in the retirement and benefit plans of HFC. Our share of retirement and benefit plan costs was \$1.4 million and \$1.7 million for the three months ended March 31, 2015 and 2014, respectively.

We have an incentive plan (“Long-Term Incentive Plan”) for employees and non-employee directors who perform services for us. The Long-Term Incentive Plan consists of four components: restricted or phantom units, performance units, unit options and unit appreciation rights.

As of March 31, 2015, we have three types of incentive-based awards which are described below. The compensation cost charged against income was \$0.8 million for each of the three months ended March 31, 2015 and 2014. We



currently purchase units in the open market instead of issuing new units for settlement of all unit awards under our Long-Term Incentive Plan. As of March 31, 2015, 2,500,000 units were authorized to be granted under our Long-Term Incentive Plan, of which 1,537,167 have not yet been granted, assuming no forfeitures of the unvested units and full achievement of goals for the performance units already granted.

#### Restricted and Phantom Units

Under our Long-Term Incentive Plan, we grant restricted units to non-employee directors and selected employees who perform services for us, with most awards vesting over a period of one to three years. Although full ownership of the units does not transfer to the recipients until the units vest, the recipients have distribution and voting rights on these units from the date of grant.

In addition, we grant phantom units to certain employees, which vest over a period of one year. Vested units are paid in common units. Full ownership of the units does not transfer to the recipient until the units vest, and the recipients do not have voting or distribution rights on these units until they vest.

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

The fair value of each restricted unit and phantom unit award is measured at the market price as of the date of grant and is amortized over the vesting period.

A summary of restricted and phantom unit activity and changes during the three months ended March 31, 2015, is presented below:

Restricted and Phantom Units	Units	Weighted Average Grant-Date Fair Value
Outstanding at January 1, 2015 (nonvested)	126,077	\$33.43
Vesting and transfer of common units to recipients	(2,462	) 33.57
Outstanding at March 31, 2015 (nonvested)	123,615	\$33.42

As of March 31, 2015, there was \$2.3 million of total unrecognized compensation expense related to nonvested restricted unit and phantom unit grants, which is expected to be recognized over a weighted-average period of 1.3 years.

#### Performance Units

Under our Long-Term Incentive Plan, we grant performance units to selected executives who perform services for us. Performance units granted are payable based upon the growth in our distributable cash flow per common unit over the performance period, and vest over a period of three years. As of March 31, 2015, estimated unit payouts for outstanding nonvested performance unit awards ranged between 100% and 140%.

No performance units were granted during the three months ended March 31, 2015. Performance units granted in 2014 vest over a three-year performance period ending December 31, 2017. These performance units granted are payable in HEP common units. The number of units actually earned will be based on the growth of our distributable cash flow per common unit over the performance period, and can range from 50% to 150% of the target number of performance units granted. Although common units are not transferred to the recipients until the performance units vest, the recipients have distribution rights with respect to the common units from the date of grant.

A summary of performance unit activity and changes during the three months ended March 31, 2015, is presented below:

Performance Units	Units
Outstanding at January 1, 2015 (nonvested)	71,245
Vesting and transfer of common units to recipients	(11,436
Outstanding at March 31, 2015 (nonvested)	59,809

The grant-date fair value of performance units vested and transferred to recipients during the three months ended March 31, 2015, was \$0.4 million. Based on the weighted average fair value of performance units outstanding at March 31, 2015, of \$2.2 million, there was \$0.9 million of total unrecognized compensation expense related to nonvested performance units, which is expected to be recognized over a weighted-average period of 1.4 years.

#### Note 6: Debt

Credit Agreement

At March 31, 2015, we had a \$650 million senior secured revolving credit facility (the “Credit Agreement”) expiring in November 2018. On April 28, 2015, the Credit Agreement was amended, increasing the size of the credit facility from \$650 million to \$850 million. The Credit Agreement is available to fund capital expenditures, investments, acquisitions, distribution payments and working capital and for general partnership purposes. It is also available to fund letters of credit up to a \$50 million sub-limit. The Credit Agreement expires in November 2018.

Our obligations under the Credit Agreement are collateralized by substantially all of our assets. Indebtedness under the Credit Agreement is recourse to HEP Logistics Holdings, L.P. (“HEP Logistics”), our general partner, and is guaranteed by our material wholly-owned subsidiaries. Any recourse to HEP Logistics would be limited to the extent of its assets, which other than its

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

investment in us, are not significant. We may prepay all loans at any time without penalty, except for payment of certain breakage and related costs.

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

#### Senior Notes

We have \$300 million in aggregate principal amount outstanding of 6.5% senior notes (the "6.5% Senior Notes") maturing March 2020. The 6.5% Senior Notes are unsecured and impose certain restrictive covenants, with which we are currently in compliance, including limitations on our ability to incur additional indebtedness, make investments, sell assets, incur certain liens, pay distributions, enter into transactions with affiliates, and enter into mergers. At any time when the 6.5% Senior Notes are rated investment grade by both Moody's and Standard & Poor's and no default or event of default exists, we will not be subject to many of the foregoing covenants. Additionally, we have certain redemption rights at varying premiums over face value under the 6.5% Senior Notes.

In March 2014, we redeemed the \$150 million aggregate principal amount of 8.25% Senior Notes maturing March 2018 at a redemption cost of \$156.2 million, at which time we recognized a \$7.7 million early extinguishment loss consisting of a \$6.2 million debt redemption premium and unamortized discount and financing costs of \$1.5 million. We funded the redemption with borrowings under our Credit Agreement.

Indebtedness under the 6.5% Senior Notes involves recourse to HEP Logistics, our general partner, and is guaranteed by our material, wholly-owned subsidiaries. However, any recourse to HEP Logistics would be limited to the extent of its assets, which other than its investment in us, are not significant.

#### Long-term Debt

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

	March 31, 2015	December 31, 2014
	(In thousands)	
Credit Agreement	\$594,000	\$571,000
6.5% Senior Notes		
Principal	300,000	300,000
Unamortized discount	(3,258)	(3,421)
	296,742	296,579
Total long-term debt	\$890,742	\$867,579

#### Interest Rate Risk Management

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

As of March 31, 2015, we have three interest rate swaps that hedge our exposure to the cash flow risk caused by the effects of LIBOR changes on \$305 million of Credit Agreement advances. Our first interest rate swap effectively converts \$155 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.99% plus an applicable margin of 2.00% as of March 31, 2015, which equaled an effective interest rate of 2.99%. This swap contract matures in February 2016. We have two additional interest rate swaps with identical terms which effectively convert \$150 million of our LIBOR based debt to fixed rate debt having an interest rate of 0.74% plus an applicable margin of 2.00% as of March 31, 2015, which equaled an effective interest rate of 2.74%. Both of these swap contracts mature in July 2017.

We have designated these interest rate swaps as cash flow hedges. Based on our assessment of effectiveness using the change in variable cash flows method, we have determined that these interest rate swaps are effective in offsetting the variability in interest payments on \$305 million of our variable rate debt resulting from changes in LIBOR. Under hedge accounting, we adjust our

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HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

cash flow hedges on a quarterly basis to their fair values with the offsetting fair value adjustments to accumulated other comprehensive income (loss). Also on a quarterly basis, we measure hedge effectiveness by comparing the present value of the cumulative change in the expected future interest to be paid or received on the variable leg of our swaps against the expected future interest payments on \$305 million of our variable rate debt. Any ineffectiveness is recorded directly to interest expense. As of March 31, 2015, we had no ineffectiveness on our cash flow hedges.

At March 31, 2015, we have accumulated other comprehensive loss of \$0.8 million that relates to our current cash flow hedging instruments. Approximately \$0.9 million will be transferred from accumulated other comprehensive income into interest expense as interest is paid on the underlying swap agreement over the next twelve-month period, assuming interest rates remain unchanged.

Additional information on our interest rate swaps is as follows:

Derivative Instrument	Balance Sheet Location (In thousands)	Fair Value	Location of Offsetting Balance	Offsetting Amount
March 31, 2015				
Interest rate swaps designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contract (\$155 million of LIBOR-based debt interest)	Other long-term liabilities	\$(942 )	Accumulated other comprehensive loss	\$(942 )
Variable-to-fixed interest rate swap contracts (\$150 million of LIBOR-based debt interest)	Other long-term assets	147	Accumulated other comprehensive income	147
		\$(795 )		\$(795 )
December 31, 2014				
Interest rate swaps designated as cash flow hedging instrument:				
Variable-to-fixed interest rate swap contract (\$155 million of LIBOR-based debt interest)	Other long-term liabilities	\$(1,065 )	Accumulated other comprehensive loss	\$(1,065 )
Variable-to-fixed interest rate swap contracts (\$150 million of LIBOR-based debt interest)	Other long-term assets	1,019	Accumulated other comprehensive income	1,019
		\$(46 )		\$(46 )

Interest Expense and Other Debt Information

Interest expense consists of the following components:

	Three Months Ended March 31, 2015                      2014 (In thousands)	
Interest on outstanding debt:		
Credit Agreement, net of interest on interest rate swaps	\$3,657	\$2,698
6.5% Senior Notes	4,875	4,875
8.25% Senior Notes	—	2,544
Amortization of discount and deferred debt issuance costs	436	511

Commitment fees	77	202
Total interest incurred	9,045	10,830
Less capitalized interest	277	376
Net interest expense	\$8,768	\$10,454
Cash paid for interest	\$13,400	\$18,782

Note 7: Significant Customers

All revenues are domestic revenues, of which 90% are currently generated from our two largest customers: HFC and Alon. The vast majority of our revenues are derived from activities conducted in the southwest United States.

The following table presents the percentage of total revenues generated by each of these customers:

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

	Three Months Ended March 31,		
	2015	2014	
HFC	81	% 83	%
Alon	9	% 10	%

Note 8: Related Party Transactions

We serve HFC's refineries under long-term pipeline and terminal, tankage and throughput agreements expiring from 2019 to 2026. Under these agreements, HFC agrees to transport, store and throughput volumes of refined product and crude oil on our pipelines and terminal, tankage and loading rack facilities that result in minimum annual payments to us. These minimum annual payments or revenues are subject to annual tariff rate adjustments on July 1st each year based on the Producer Price Index ("PPI") or Federal Energy Regulatory Commission ("FERC") index. As of March 31, 2015, these agreements with HFC will result in minimum annual payments to us of \$231.6 million.

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

Under certain provisions of an omnibus agreement we have with HFC (the "Omnibus Agreement"), we pay HFC an annual administrative fee (currently \$2.4 million) for the provision by HFC or its affiliates of various general and administrative services to us. This fee does not include the salaries of personnel employed by HFC who perform services for us on behalf of HLS or the cost of their employee benefits, which are charged to us separately by HFC. Also, we reimburse HFC and its affiliates for direct expenses they incur on our behalf.

Related party transactions with HFC are as follows:

Revenues received from HFC were \$72.3 million and \$71.8 million for the three months ended March 31, 2015 and 2014, respectively.

HFC charged us general and administrative services under the Omnibus Agreement of \$0.6 million for each of the three months ended March 31, 2015 and 2014.

We reimbursed HFC for costs of employees supporting our operations of \$8.8 million and \$9.2 million for the three months ended March 31, 2015 and 2014, respectively.

HFC reimbursed us \$2.6 million and \$4.5 million for the three months ended March 31, 2015 and 2014, respectively, for certain reimbursable costs and capital projects.

We distributed \$21.6 million and \$19.2 million for the three months ended March 31, 2015 and 2014, respectively, to HFC as regular distributions on its common units and general partner interest, including general partner incentive distributions.

Accounts receivable from HFC were \$28.0 million and \$33.4 million at March 31, 2015, and December 31, 2014, respectively.

Accounts payable to HFC were \$15.8 million and \$5.2 million at March 31, 2015, and December 31, 2014, respectively.

Revenues for the three months ended March 31, 2015 and 2014, include \$5.6 million and \$7.4 million, respectively, of shortfall payments billed in 2014 and 2013, as HFC did not exceed its minimum volume commitment in any of the subsequent four quarters. Deferred revenue in the consolidated balance sheets at March 31, 2015, and December 31,



2014, includes \$3.7 million and \$7.3 million, respectively, relating to certain shortfall billings. It is possible that HFC may not exceed its minimum obligations to receive credit for any of the \$3.7 million deferred at March 31, 2015.

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HOLLY ENERGY PARTNERS, L.P.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 (Unaudited) Continued

Note 9: Partners' Equity

As of March 31, 2015, HFC held 22,380,030 of our common units and the 2% general partner interest, which together constituted a 39% ownership interest in us.

Allocations of Net Income

Net income attributable to HEP is allocated between limited partners and the general partner interest in accordance with the provisions of the partnership agreement. HEP net income allocated to the general partner includes incentive distributions that are declared subsequent to quarter end. After the amount of incentive distributions is allocated to the general partner, the remaining net income attributable to HEP is allocated to the partners based on their weighted-average ownership percentage during the period.

The following table presents the allocation of the general partner interest in net income for the periods presented below:

	Three Months Ended March 31,	
	2015	2014
	(In thousands)	
General partner interest in net income	\$449	\$329
General partner incentive distribution	9,361	7,672
Total general partner interest in net income	\$9,810	\$8,001

Cash Distributions

Our general partner, HEP Logistics, is entitled to incentive distributions if the amount we distribute with respect to any quarter exceeds specified target levels.

On April 23, 2015, we announced our cash distribution for the first quarter of 2015 of \$0.5375 per unit. The distribution is payable on all common and general partner units and will be paid May 15, 2015, to all unitholders of record on May 6, 2015.

The following table presents the allocation of our regular quarterly cash distributions to the general and limited partners for the periods in which they apply. Our distributions are declared subsequent to quarter end; therefore, the amounts presented do not reflect distributions paid during the periods presented below.

	Three Months Ended March 31,	
	2015	2014
	(In thousands, except per unit data)	
General partner interest in distribution	\$860	\$790
General partner incentive distribution	9,361	7,672
Total general partner distribution	10,221	8,462
Limited partner distribution	31,528	29,768
Total regular quarterly cash distribution	\$41,749	\$38,230
Cash distribution per unit applicable to limited partners	\$0.5375	\$0.5075

As a master limited partnership, we distribute our available cash, which historically has exceeded our net income attributable to HEP because depreciation and amortization expense represents a non-cash charge against income. The result is a decline in our partners' equity since our regular quarterly distributions have exceeded our quarterly net

income attributable to HEP. Additionally, if the asset contributions and acquisitions from HFC had occurred while we were not a consolidated variable interest entity of HFC, our acquisition cost, in excess of HFC's historical basis in the transferred assets would have been recorded in our financial statements at the time of acquisition, as increases to our properties and equipment and intangible assets instead of decreases to our partners' equity.

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HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

Note 10: Environmental

We expensed \$4.2 million for environmental remediation obligations for the three months ended March 31, 2015, and incurred a credit of \$0.2 million due to the revision of an accrual for the three months ended March 31, 2014. During the three months ended March 31, 2015, we increased certain environmental cost accruals to reflect revisions to the cost estimates and the time frame for which the related environmental remediation and monitoring activities are expected to occur. The accrued environmental liability reflected in our consolidated balance sheets was \$9.0 million and \$5.2 million at March 31, 2015 and December 31, 2014, respectively, of which \$6.9 million and \$2.8 million, respectively, were classified as other long-term liabilities. These accruals include remediation and monitoring costs expected to be incurred over an extended period of time.

Note 11: Contingencies

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

Note 12: Supplemental Guarantor/Non-Guarantor Financial Information

Obligations of HEP (“Parent”) under the Senior Notes have been jointly and severally guaranteed by each of its direct and indirect 100% owned subsidiaries (“Guarantor Subsidiaries”). These guarantees are full and unconditional, subject to certain customary release provisions. These circumstances include (i) when a Guarantor Subsidiary is sold or sells all or substantially all of its assets, (ii) when a Guarantor Subsidiary is declared “unrestricted” for covenant purposes, (iii) when a Guarantor Subsidiary’s guarantee of other indebtedness is terminated or released and (iv) when the requirements for legal defeasance or covenant defeasance or to discharge the Senior Notes have been satisfied.

The following financial information presents condensed consolidating balance sheets, statements of comprehensive income, and statements of cash flows of the Parent, the Guarantor Subsidiaries and the Non-Guarantor Subsidiaries. The information has been presented as if the Parent accounted for its ownership in the Guarantor Subsidiaries, and the Guarantor Restricted Subsidiaries accounted for the ownership of the Non-Guarantor Non-Restricted Subsidiaries, using the equity method of accounting.

HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

## Condensed Consolidating Balance Sheet

March 31, 2015	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$2	\$2,780	\$3,020	\$—	\$5,802
Accounts receivable	—	35,528	4,537	(210 )	39,855
Prepaid and other current assets	211	2,982	1,196	—	4,389
Total current assets	213	41,290	8,753	(210 )	50,046
Properties and equipment, net	—	624,149	379,839	—	1,003,988
Investment in subsidiaries	608,299	288,355	—	(896,654 )	—
Transportation agreements, net	—	78,967	—	—	78,967
Goodwill	—	256,498	—	—	256,498
Investment in SLC Pipeline	—	24,462	—	—	24,462
Other assets	1,315	9,323	—	—	10,638
Total assets	\$609,827	\$1,323,044	\$388,592	\$(896,864 )	\$1,424,599
<b>LIABILITIES AND PARTNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$—	\$27,600	\$1,102	\$(210 )	\$28,492
Accrued interest	1,625	179	—	—	1,804
Deferred revenue	—	6,132	1,687	—	7,819
Accrued property taxes	—	1,586	1,159	—	2,745
Other current liabilities	97	4,297	8	—	4,402
Total current liabilities	1,722	39,794	3,956	(210 )	45,262
Long-term debt	296,742	594,000	—	—	890,742
Other long-term liabilities	163	21,768	162	—	22,093
Deferred revenue	—	30,649	—	—	30,649
Class B unit	—	28,534	—	—	28,534
Equity - partners	311,200	608,299	384,474	(992,773 )	311,200
Equity - noncontrolling interest	—	—	—	96,119	96,119
Total liabilities and partners' equity	\$609,827	\$1,323,044	\$388,592	\$(896,864 )	\$1,424,599

HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

## Condensed Consolidating Balance Sheet

December 31, 2014	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
<b>ASSETS</b>					
Current assets:					
Cash and cash equivalents	\$2	\$2,828	\$—	\$—	\$2,830
Accounts receivable	—	34,274	6,044	(189 )	40,129
Prepaid and other current assets	212	2,856	1,315	—	4,383
Total current assets	214	39,958	7,359	(189 )	47,342
Properties and equipment, net	—	596,988	383,491	—	980,479
Investment in subsidiaries	622,100	285,247	—	(907,347 )	—
Transportation agreements, net	—	80,703	—	—	80,703
Goodwill	—	256,498	—	—	256,498
Investment in SLC Pipeline	—	24,478	—	—	24,478
Other assets	1,319	10,736	—	—	12,055
Total assets	\$623,633	\$1,294,608	\$390,850	\$(907,536 )	\$1,401,555
<b>LIABILITIES AND PARTNERS' EQUITY</b>					
Current liabilities:					
Accounts payable	\$—	\$15,495	\$2,575	\$(189 )	\$17,881
Accrued interest	6,500	115	—	—	6,615
Deferred revenue	—	5,672	6,760	—	12,432
Accrued property taxes	—	1,902	801	—	2,703
Other current liabilities	45	4,408	118	—	4,571
Total current liabilities	6,545	27,592	10,254	(189 )	44,202
Long-term debt	296,579	571,000	—	—	867,579
Other long-term liabilities	147	17,731	267	—	18,145
Deferred revenue	—	29,392	—	—	29,392
Class B unit	—	26,793	—	—	26,793
Equity - partners	320,362	622,100	380,329	(1,002,429 )	320,362
Equity - noncontrolling interest	—	—	—	95,082	95,082
Total liabilities and partners' equity	\$623,633	\$1,294,608	\$390,850	\$(907,536 )	\$1,401,555

HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

## Condensed Consolidating Statement of Comprehensive Income

Three Months Ended March 31, 2015	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$63,056	\$9,224	\$(25 )	\$72,255
Third parties	—	11,387	6,114	—	17,501
	—	74,443	15,338	(25 )	89,756
Operating costs and expenses:					
Operations (exclusive of depreciation and amortization)	—	25,531	2,460	(25 )	27,966
Depreciation and amortization		10,962	3,732	—	14,694
General and administrative	1,063	2,227	—	—	3,290
	1,063	38,720	6,192	(25 )	45,950
Operating income (loss)	(1,063 )	35,723	9,146	—	43,806
Equity in earnings (loss) of subsidiaries	37,933	6,860	—	(44,793 )	—
Equity in earnings of SLC Pipeline	—	734	—	—	734
Interest expense	(5,067 )	(3,701 )	—	—	(8,768 )
Other income	—	159	—	—	159
	32,866	4,052	—	(44,793 )	(7,875 )
Income (loss) before income taxes	31,803	39,775	9,146	(44,793 )	35,931
State income tax expense	—	(101 )	—	—	(101 )
Net income (loss)	31,803	39,674	9,146	(44,793 )	35,830
Allocation of net income attributable to noncontrolling interests	—	—	—	(4,027 )	(4,027 )
Net income (loss) attributable to Holly Energy Partners	31,803	39,674	9,146	(48,820 )	31,803
Other comprehensive income (loss)	(749 )	(749 )	—	749	(749 )
Comprehensive income (loss)	\$31,054	\$38,925	\$9,146	\$(48,071 )	\$31,054

HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

## Condensed Consolidating Statement of Comprehensive Income

Three Months Ended March 31, 2014	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Non-Restricted Subsidiaries	Eliminations	Consolidated
	(In thousands)				
Revenues:					
Affiliates	\$—	\$61,615	\$ 10,524	\$(307 )	\$71,832
Third parties	—	11,081	4,091	—	15,172
	—	72,696	14,615	(307 )	87,004
Operating costs and expenses:					
Operations (exclusive of depreciation and amortization)	—	20,151	2,968	(307 )	22,812
Depreciation and amortization	—	11,993	3,595	—	15,588
General and administrative	1,058	2,093	—	—	3,151
	1,058	34,237	6,563	(307 )	41,551
Operating income (loss)	(1,058 )	38,459	8,052	—	45,453
Equity in earnings (loss) of subsidiaries	40,564	6,039	—	(46,603 )	—
Equity in earnings of SLC Pipeline	—	522	—	—	522
Interest expense	(7,686 )	(2,768 )	—	—	(10,454 )
Interest income	—	3	—	—	3
Loss on early extinguishment of debt	(7,677 )	—	—	—	(7,677 )
Other income	—	8	—	—	8
	25,201	3,804	—	(46,603 )	(17,598 )
Income (loss) before income taxes	24,143	42,263	8,052	(46,603 )	27,855
State income tax expense	—	(75 )	—	—	(75 )
Net income (loss)	24,143	42,188	8,052	(46,603 )	27,780
Allocation of net income attributable to noncontrolling interests	—	—	—	(3,637 )	(3,637 )
Net income (loss) attributable to Holly Energy Partners	24,143	42,188	8,052	(50,240 )	24,143
Other comprehensive income (loss)	95	95	—	(95 )	95
Comprehensive income (loss)	\$24,238	\$42,283	\$ 8,052	\$(50,335 )	\$24,238



HOLLY ENERGY PARTNERS, L.P.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited) Continued

## Condensed Consolidating Statement of Cash Flows

Three Months Ended March 31, 2015	Parent	Guarantor Restricted Subsidiaries	Non-Guarantor Subsidiaries	Non-Restricted	Eliminations	Consolidated
	(In thousands)					
Cash flows from operating activities	\$(9,873 )	\$63,128	\$8,328		\$(692 )	\$60,891
Cash flows from investing activities						
Additions to properties and equipment	—	(10,983 )	(308 )		—	(11,291 )
Purchase of El Dorado crude tanks	—	(27,500 )	—		—	(27,500 )
Proceeds from sale of assets	—	218	—		—	218
Distributions from UNEV	—	3,058	—		(3,058 )	—
Distributions in excess of equity in earnings in SLC Pipeline	—	16	—		—	16
	—	(35,191 )	(308 )		(3,058 )	(38,557 )
Cash flows from financing activities						
Net borrowings under credit agreement	—	23,000	—		—	23,000
Net intercompany financing activities	50,985	(50,985 )	—		—	—
Redemption of senior notes	—	—	—		—	—
Distributions to HEP unitholders	(40,865 )	—	—		—	(40,865 )
Distributions to noncontrolling interests	—	—	(5,000 )		3,750	(1,250 )
Purchase of units for incentive grants	(247 )	—	—			

The Audit Committee oversees Capital Southwest's financial reporting process and system of internal control over financial reporting on behalf of the Board. Management is responsible for preparing Capital Southwest's financial statements and Capital Southwest's reporting

process, including Capital Southwest's system of internal control over financial reporting. In fulfilling its oversight responsibilities, the Audit Committee reviewed the audited consolidated financial statements in the Annual Report with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of the valuation of securities and other significant judgments, and the clarity of disclosures in the financial statements. The Audit Committee is not, however, professionally engaged in the practice of accounting or auditing, and does not provide any expert or other special assurance as to such financial statements concerning compliance with the laws, regulations or accounting principles generally accepted in the United States ("GAAP"). The Audit Committee relies, without independent verification, on the information provided to them and on the representations made by management and Capital Southwest's independent registered public accounting firm.

The Company's independent registered public accounting firm, RSM US LLP, was responsible for performing an independent audit of Capital Southwest's consolidated financial statements for the fiscal year ended March 31, 2018 in accordance with the standards of the Public Company Accounting Oversight Board (United States) ("PCAOB") and for expressing an opinion on the conformity of those audited financial statements with GAAP. The Audit Committee reviewed with RSM US LLP its judgment as to the quality, not just the acceptability, of Capital Southwest's accounting principles, the reasonableness of the valuation of securities and other significant judgments, the clarity of disclosures in the financial statements and such other matters as are required to be discussed with the Audit Committee by Statements on Auditing Standards No. 1301, as adopted by the PCAOB in Rule 3200T and by SEC Regulations S-X Rule 2-07, Communications with Audit Committees, as currently in effect. The Audit Committee has received the written disclosures and the

letter from RSM US LLP required by applicable requirements of the PCAOB regarding RSM US LLP's communications with the Audit Committee concerning RSM US LLP's independence, and has discussed with RSM US LLP the independent accountant's independence.

The Audit Committee discussed with RSM US LLP the overall scope and plans for their audit and also met with them, with and without management present, to discuss the results of their audit, their evaluation of Capital Southwest's system of internal controls over financial reporting and the overall quality of Capital Southwest's financial reporting.

The Audit Committee reviewed and discussed the audited consolidated financial statements for the fiscal year ended March 31, 2018 with management and RSM US LLP and also discussed with management and RSM US LLP the process used to support certifications by our Chief Executive Officer and Chief Financial Officer that are required by the SEC and Sarbanes-Oxley to accompany our periodic

filings with the SEC.

Based on the reviews and discussions referred to above and subject to the limitations on the Audit Committee's role and responsibilities referred to above and in the Audit Committee charter, all of the Audit Committee members, whose names are listed below, recommended to the Board that the Board approve the inclusion of the audited consolidated financial statements for the fiscal year ended March 31, 2018 in the Annual Report on Form 10 K.

Audit Committee  
Jack D. Furst,  
Chairman  
David R. Brooks  
T. Duane Morgan  
William R. Thomas  
III  
John H. Wilson

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SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the 1934 Act requires our officers and directors and persons who beneficially own 10% or more of our common stock to file reports of securities ownership and changes in such ownership with the SEC. Officers, directors and greater than 10% beneficial owners also are required by SEC rules to furnish us with copies of all Section 16(a) reports they file with the SEC. Based upon a review of the reports furnished to us and the written representations of our directors and officers, we believe that each of our officers, directors and 10% beneficial owners complied with all Section 16(a) filing requirements applicable to them during fiscal 2018, with the exception of Douglas Kelley and William Ashbaugh. Mr. Kelley and Mr. Ashbaugh each filed one late report for two transactions subject to Section 16(a) filing requirements. Mr. Kelley and Mr. Ashbaugh each failed to timely report the withholding of shares to pay taxes applicable to the vesting of restricted stock.

CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

We have written procedures in place for the review, approval and monitoring of transactions involving us and certain persons related to us. As a BDC, the 1940 Act restricts us from participating in transactions with any persons affiliated with us, including our officers, directors and employees and any person controlling or under common control with us, subject to limited exceptions.

In order to ensure that we do not engage in any prohibited transactions with any persons affiliated with CSWC, our officers screen each of our transactions for any possible affiliations, close or remote, between the proposed portfolio investment, us, companies controlled by us and our employees and directors. The Audit Committee is responsible for approving related party transactions exceeding \$50,000 in aggregate value.

In addition, our Code of Conduct and Code of Ethics, which are applicable to all of our employees, officers and directors, require that all employees, officers and directors avoid any conflict, or the appearance of a conflict, between an individual's personal interests and our interests. Our Code of Conduct and Code of Ethics are available at <http://www.capitalsouthwest.com/governance>.

OTHER MATTERS

As of the mailing date of this proxy statement, the Board knows of no other matters to be presented at the meeting. Should any of the matters requiring a vote of the shareholders arise at the meeting, the persons named in the proxy will vote the proxies in accordance with their best judgment.

Shareholder Proposals for 2019 Annual Meeting

Any shareholder proposal for the annual meeting in 2019 must be sent to our corporate secretary at 5400 LBJ Freeway, Suite 1300, Dallas, Texas 75240, Attention: Secretary. The deadline for receipt of a proposal to be considered for inclusion in the 2019 proxy statement is 5 p.m., Central Time, on February 8, 2019. Our NCG Committee will review all shareholder proposals and makes recommendations to the Board for action on such proposals. All proposals must meet the requirements set forth in the rules and regulations of the SEC in order to be eligible for inclusion in the proxy statement for that meeting.

Our bylaws require that any shareholder wishing to nominate a candidate for director or to propose other business at the annual meeting in 2019 (other than proposals submitted pursuant to the SEC's Rule 14a-8) must give us written notice between February 8, 2019 and March 10, 2019, unless the 2019 annual meeting is called for a date that is not within 30 days before or after the anniversary of the 2018 annual meeting, in which case notice must be received in compliance with our bylaws. The notice must comply with the requirements of our bylaws, which may be found on

our corporate website at [www.capitalsouthwest.com/governance](http://www.capitalsouthwest.com/governance), and any applicable law. Any such business should be addressed to our corporate secretary at 5400 LBJ Freeway, Suite 1300, Dallas, Texas 75240, Attention: Secretary. Any proposal or nomination that is not timely received by our Secretary or otherwise does not meet the requirements set forth in our bylaws or applicable SEC rules may not be considered at the next annual meeting.

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Reduce Duplicate Mailings

We are required to provide an annual report and proxy statement or notice of availability of these materials to all shareholders of record. If you share an address with another shareholder, you may receive only one set of proxy materials unless you have provided contrary instructions, we or your broker may discontinue mailings of multiple copies.

Once you have received notice from the account holder or us that they or we will discontinue sending multiple copies to the same address, you will receive only one copy until you are notified otherwise or until you revoke your consent. If you received only one copy of this proxy statement, the annual report and notice of availability of these materials and you wish to receive a separate copy for each shareholder at your household, or if, at any time, you wish to resume receiving separate proxy statements or annual reports or notices of availability, or if you are receiving multiple statements and reports and wish to receive only one, please notify your broker if your shares are held in a brokerage account or us if you hold registered shares in your name. You can notify us by sending a written request to Capital Southwest Corporation, 5400 LBJ Freeway, Suite 1300, Dallas, Texas 75240, Attention: Secretary, or by contacting us at (214) 238 5700, and we will promptly deliver materials as requested.



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Appendix A

Capital Southwest Corporation Amended and Restated 2010 Restricted Stock Award Plan

1. PURPOSE

This Plan is intended to foster and promote the long-term financial success of Capital Southwest Corporation and its Subsidiaries (the “Company Group”); to reward performance and to increase shareholder value by providing Participants appropriate incentives and rewards; to enable the Company Group to attract and retain the services of outstanding individuals upon whose judgment, interest and dedication the successful conduct of the Company Group’s businesses are largely dependent; to encourage Participants’ ownership interest in Capital Southwest Corporation; and to align the interests of employees with that of the Company’s shareholders.

2. DEFINITIONS

(a) “1940 Act” means the Investment Company Act of 1940, as amended.

(b) “Affiliate” means any “parent corporation” or “subsidiary corporation” of the Company, as such term is defined in Code Sections 424(e) and 424(f).

(c) “Award Agreement” means a written or electronic agreement evidencing and setting forth the terms of a Restricted Stock Award.

(d) “Board of Directors” means the board of directors of the Company.

(e) “Cause” means, unless otherwise specified in the Award Agreement or in an employment agreement with any member of the Company Group, with respect to a Participant:

(i) Commission of any act or acts of personal dishonesty intended to result in substantial personal enrichment to the Employee to the detriment of any Company Group member;

(ii) Conviction of, or entering into a plea of nolo contendere to, a felony;

(iii) In the case of an Employee, repeated failures to perform his responsibilities that are demonstrably willful and deliberate;

(iv) Intentional, repeated or continuing violation of any of the applicable Company Group member’s policies or procedures that occurs or continues after notice to the Participant that he or she has violated such policy or procedure; or

(v) Any material breach of a written covenant or agreement with a Company Group member, including the terms of this Plan or any material breach of fiduciary duty to a Company Group member.

A Participant shall be considered to have been discharged for Cause if the Company determines within 30 days after his resignation or discharge that discharge for Cause was warranted.

(f) “Change in Control” means

(i) The date any one person, or more than one “person” acting as a group, acquires (or has acquired during the twelve-month period ending on the date of the most recent acquisition by such person(s)) ownership of Common Stock possessing 51% or more of the total voting power of the Common Stock of the Company;

(ii) Individuals who at any time during the term of this Agreement constitute the board of directors of the Company (the “Incumbent Board”) cease for any reason to constitute at least a majority thereof, provided that any person becoming a director subsequent to the date hereof whose election or nomination for election was

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approved by a vote of at least 75% of the directors comprising the Incumbent Board (either by a specific vote or by approval of the proxy statement of the Company in which such person is named as a nominee for director, without objection to such nomination) shall be, for purposes of this clause (ii) considered as though such person were a member of the Incumbent Board;

(iii) Any consolidation or merger to which the Company is a party, if following such consolidation or merger, shareholders of the Company immediately prior to such consolidation or merger shall not beneficially own securities representing at least 51% of the combined voting power of the outstanding voting securities of the surviving or continuing corporation; or

(iv) Any sale, lease, exchange or other transfer (in one transaction or in a series of related transactions) of all, or substantially all, of the assets of the Company, other than to an entity (or entities) of which the Company or the shareholders of the Company immediately prior to such transaction beneficially own securities representing at least 51% of the combined voting power of the outstanding voting securities.

(g) “Code” means the Internal Revenue Code of 1986, as amended.

(h) “Committee” means the Compensation Committee of the Board of Directors.

(i) “Common Stock” means the Common Stock of the Company, par value, \$1.00 per share.

(j) “Company” means Capital Southwest Corporation, a corporation organized under the laws of the State of Texas, and all successors to it.

(k) “Date of Grant” means the date when the Company completes the corporate action necessary to create the legally binding right constituting a Restricted Stock Award.

(l) “Disability” has the meaning set forth in Code Section 22(e)(3).

(m) “Effective Date” means the date the Plan is approved by the shareholders of the Company.

(n) “Employee” means any person employed by the Company or a Subsidiary. Directors who are employed by the Company or a Subsidiary shall be considered Employees under the Plan.

(o) “Exchange Act” means the Securities Exchange Act of 1934, as amended.

(p) “Fair Market Value” on any date means the closing sales price of the Common Stock on the Nasdaq Global Select Market (or any other such exchange on which the Common Stock may be traded in the future) on the date of determination. Whenever possible, the determination of Fair Market Value by the Committee shall be based on the prices reported in The Wall Street Journal. The Committee’s determination of Fair Market Value shall be conclusive and binding on all persons.

(q) “Good Reason” means, unless otherwise specified in the Award Agreement or in an employment agreement with any member of the Company Group, with respect to a Participant, any one or combination of the following events without the Participant’s consent:

(i) a diminution in the Participant’s compensation;

(ii) a diminution in the Participant’s authority, duties or responsibilities; and

(iii) a relocation of 50 miles or more of the Participant’s primary work location.

A Participant shall be considered to have terminated for Good Reason only if: (A) the Participant provides notice to the Company of the Good Reason event(s) within 30 days of the initial occurrence of such event(s); (B) the Company has 60

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days from the date such notice is received to cure such Good Reason event(s) but fails to do so; and (C) the Participant voluntarily terminates employment within 6 months of the initial occurrence of such Good Reason event(s).

- (r) "Participant" means any person who holds an outstanding Restricted Stock Award.
- (s) "Plan" means this Capital Southwest Corporation Amended and Restated 2010 Restricted Stock Award Plan.
- (t) "Restricted Stock" or "Restricted Stock Award" means, individually or collectively, a grant of Shares under the Plan.
- (u) "Share" means a share of Common Stock.
- (v) "Subsidiary" means Capital Southwest Management Company.
- (w) "Termination of Service" shall mean the termination of employment of an Employee by the Company and all Subsidiaries. A Participant's service shall not be deemed to have terminated because of a change in the entity for which the Participant renders such service, provided that there is no interruption or termination of the Participant's service. Furthermore, a Participant's service with the Company Group shall not be deemed to have terminated if the Participant takes any military leave, sick leave, or other bona fide leave of absence approved by the Company or a Subsidiary; provided, however, that if any such leave exceeds 90 days, on the 91st day of such leave the Participant's service shall be deemed to have terminated unless the Participant's leave of absence is approved by the Committee. Except as otherwise provided in any Award Agreement, the Participant's service shall be deemed to have terminated upon the entity for which the Participant performs service ceasing to be a Subsidiary (or any successor). Subject to the foregoing, the Company, in its discretion, shall determine whether a Participant's service has terminated and the effective date of such termination.

3. ADMINISTRATION

The Committee shall administer the Plan. The Committee shall consist of two or more disinterested directors of the Company, who shall be appointed by the Board of Directors. A member of the Board of Directors shall be deemed to be "disinterested" only if he satisfies such requirements as the Securities and Exchange Commission may establish for non-employee directors administering plans intended to qualify for exemption under Rule 16b-3 (or its successor) under the Exchange Act. The Committee shall have full and final authority, in each case subject to and consistent with the provisions of the Plan and subject to the approval by the required majority of the Company's directors, as defined in Section 57(o) of the 1940 Act:

- (a) The Committee shall have the sole and complete authority to:
  - (i) Determine the Employees to whom Restricted Stock Awards are granted, the type and amounts of Restricted Stock Awards to be granted and the time of all such grants;
  - (ii) Determine the terms, conditions and provisions of, and restrictions relating to, each Restricted Stock Award granted;
  - (iii) Interpret and construe the Plan and all Award Agreements;
  - (iv) Prescribe, amend and rescind rules and regulations relating to the Plan;
  - (v) Determine the content and form of all Award Agreements;
  - (vi) Determine all questions relating to Restricted Stock Awards under the Plan, including whether any conditions relating to a Restricted Stock Award have been met;

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- (vii) Consistent with the Plan and with the consent of the Participant, as appropriate, amend any outstanding Restricted Stock Award or amend the exercise date or dates thereof;
  - (viii) Determine the duration and purpose of leaves of absence that may be granted to a Participant without constituting termination of the Participant's employment for the purpose of the Plan or any Restricted Stock Award;
  - (ix) Maintain accounts, records and ledgers relating to Restricted Stock Awards;
  - (x) Maintain records concerning its decisions and proceedings;
  - (xi) Employ agents, attorneys, accountants or other persons for such purposes as the Committee considers necessary or desirable; and
  - (xii) Do and perform all acts which it may deem necessary or appropriate for the administration of the Plan and to carry out the objectives of the Plan.
- (b) Each Restricted Stock Award shall be evidenced by an Award Agreement containing such provisions as may be approved by the Committee. Each Award Agreement shall constitute a binding contract between the Company and the Participant, and every Participant, upon acceptance of the Award Agreement, shall be bound by the terms and restrictions of the Plan and the Award Agreement. The terms of each Award Agreement shall be in accordance with the Plan, but each Award Agreement may include such additional provisions and restrictions determined by the Committee, in its discretion, provided that such additional provisions and restrictions are not inconsistent with the terms of the Plan. In particular, and at a minimum, the Committee shall set forth in each Award Agreement (i) the number of Shares subject to the Restricted Stock Award; (ii) the expiration date of the Restricted Stock Award; (iii) the manner, time, and rate (cumulative or otherwise) of vesting of such Restricted Stock Award; and (iv) the restrictions, if any, placed upon such Restricted Stock Award, or upon Shares which may be issued upon vesting of such Restricted Stock Award. The Chairman of the Committee and such other directors and officers as shall be designated by the Committee is hereby authorized to execute Award Agreements on behalf of the Company and to cause them to be delivered to the recipients of Restricted Stock Awards.

4. STOCK SUBJECT TO THE PLAN

(a) General Limitations.

(i) Subject to adjustment as provided in Section 11 of the Plan, the maximum number of Shares reserved for issuance in connection with Restricted Stock Awards under the Plan is 1,488,000 Shares. Subject to adjustment as provided in Section 11 of the Plan, the total number of Shares that may be outstanding as Restricted Stock under all of the Company's compensations plans shall not exceed 10% of the outstanding Shares on the effective date of the Plan plus 10% of the Shares issued or delivered by the Company (other than pursuant to any Employee compensation plans) during the term of the Plan.

(ii) The amount of voting securities that would result from the exercise of all the Company's outstanding warrants, options, and rights, together with any Restricted Stock issued pursuant to this Plan and any other compensation plan of the Company, at the time of issuance shall not exceed 25% of the outstanding voting securities of the Company; provided, however, that if the amount of voting securities that would result from the exercise of all the Company's outstanding warrants, options, and rights issued to the Company's directors, officers, and employees, together with any Restricted Stock issued pursuant to this Plan and any other compensation plan of the Company, would exceed 15% of the outstanding voting securities of the Company, then the total amount of voting securities that would result from the exercise of all outstanding warrants, options, and rights, together with any Restricted Stock issued pursuant to this Plan and any other compensation plan of the Company, at the time of issuance shall not exceed 20% of the outstanding voting securities of the Company.

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(b) Other Rules.

(i) The number of Shares associated with a Restricted Stock Award originally counted against the limitations as the result of the grant of the Restricted Stock Award shall be restored against the limitations and be available for reissuance under this Plan if and to the extent the Restricted Stock Award is surrendered, cancelled, expires, terminates or is forfeited for any reason.

(ii) Shares withheld by, or otherwise remitted to satisfy a Participant's tax withholding obligations upon the lapse of restrictions on a Restricted Stock, or upon any other payment or issuance of Shares under the Plan shall not become available for issuance or reissuance under the Plan.

(iii) Shares issued under the Plan may be either authorized but unissued Shares, authorized Shares previously issued held by the Company in its treasury which have been reacquired by the Company, or Shares purchased by the Company in the open market.

5. ELIGIBILITY

Subject to the terms of the Plan, all Employees shall be eligible to receive Restricted Stock Awards under the Plan as selected and determined by the Committee.

6. RESTRICTED STOCK AWARDS

The Committee may, subject to the limitations of the Plan and the availability of Shares reserved but not previously awarded under this Plan, grant Restricted Stock Awards to eligible Employees upon such terms and conditions as it may determine to the extent such terms and conditions are consistent with the following provisions:

(a) Payment of the Restricted Stock Award. The Restricted Stock Award may only be made in whole Shares.

(b) Terms of the Restricted Stock Awards. The Committee shall determine the dates on which Restricted Stock Awards granted to a Participant shall vest and any specific conditions which must be satisfied prior to the vesting of any installment or portion of the Restricted Stock Award. Any such vesting period will be no shorter than one year as of the Date of Grant. Notwithstanding the foregoing, up to 5% of the maximum number of Shares available for issuance under this Plan as provided for in Section 4(a), as such may be adjusted under Section 11, may be used for awards that do not at the Date of Grant comply with the one-year minimum vesting period. The Committee may, in its sole discretion, accelerate the vesting of any Restricted Stock Awards after the Date of Grant except in the event of a Change in Control. The acceleration of any Restricted Stock Award shall create no right, expectation or reliance on the part of any other Participant or that certain Participant regarding any other Restricted Stock Awards.

(c) Termination of Service. Unless otherwise determined by the Committee or as otherwise provided herein, upon a Participant's Termination of Service for any reason, including retirement, other than Disability or death, the Participant's unvested Restricted Stock Awards as of the date of termination shall be forfeited and any rights the Participant had to such unvested Restricted Stock Awards shall become null and void. Unless otherwise provided in the applicable Award Agreement, in the event of a Participant's Termination of Service due to Disability or death, all unvested Restricted Stock Awards held by such Participant shall immediately vest.

(d) Treatment Upon a Change in Control. In the event of a Change in Control, all unvested Restricted Stock Awards held by a Participant that were granted on or after the Effective Date shall vest upon the Change in Control if either (i) within two years following the Change in Control, the Participant's service is involuntarily terminated for reasons other than for Cause or the Participant terminates his or her employment or service for Good Reason or (ii) such Restricted Stock Awards are not assumed or converted into replacement awards in a manner described in Section 11(b)(iii). All unvested Restricted Stock Awards held by a Participant that were granted before the Effective Date shall continue to be subject to the terms of the Plan as in effect prior to the Effective Date.

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**7. DIVIDENDS, DISTRIBUTIONS AND OTHER RIGHTS.**

(a) Dividends. A Participant holding a Restricted Stock Award shall, unless otherwise provided in the applicable Award Agreement, be entitled to receive, with respect to each such Share covered by a Restricted Stock Award, a payment equal to any dividends or distributions.

(b) Voting of Restricted Stock Awards. After a Restricted Stock Award has been granted, but for which Shares covered by such Restricted Stock Award have not yet vested, the Participant shall be entitled to vote such Shares subject to the rules and procedures adopted by the Committee for this purpose.

(c) Restrictive Legend. Each certificate issued in respect of a Restricted Stock Award shall be registered in the name of the Participant and, at the discretion of the Board of Directors, each such certificate shall be held by the Company until the Restricted Stock has vested. Each such certificate shall bear the following (or a similar) legend:

“The transferability of this certificate and the shares of stock represented hereby are subject to the terms and conditions (including forfeiture) contained in the Capital Southwest Corporation Amended and Restated 2010 Restricted Stock Plan and an agreement entered into between the registered owner and Capital Southwest Corporation. A copy of such plan and agreement is on file at the principal office of Capital Southwest Corporation.”

**8. RIGHTS OF PARTICIPANTS**

Nothing contained in this Plan or in any Award Agreement confers on any person any right to continue in the employ or service of the Company or an Affiliate or interferes in any way with the right of the Company or an Affiliate to terminate a Participant’s services.

**9. DESIGNATION OF BENEFICIARY**

A Participant may, with the consent of the Committee, designate a person or persons to receive, in the event of death, any Restricted Stock Award to which the Participant would then be entitled. Such designation will be made upon forms supplied by and delivered to the Company and may be revoked in writing. If a Participant fails to designate a beneficiary, then the Participant’s estate will be deemed to be the beneficiary.

**10. TRANSFERABILITY OF RESTRICTED STOCK AWARDS**

No Restricted Stock Award granted hereunder shall be transferable, voluntarily or involuntarily, other than by will or by the laws of descent and distribution or pursuant to a qualified domestic relations order as defined by the Code.

**11. ADJUSTMENTS UPON CHANGES IN CAPITALIZATION OR A CHANGE IN CONTROL**

(a) Adjustment Clause. In the event of any change in the outstanding Shares by reason of any stock dividend, split, spinoff, recapitalization, merger, consolidation, combination, extraordinary dividend, exchange of shares or other change affecting the outstanding shares of Stock as a class without the Company’s receipt of consideration, or other equity restructuring within the meaning of Financial Accounting Standard No. 123 (revised 2004), appropriate adjustments shall be made to the aggregate number of shares of Stock with respect to which Restricted Stock Awards may be made under the Plan. The Committee shall also make appropriate adjustments described in the previous sentence in the event of any distribution of assets to shareholders other than a normal cash dividend. Adjustments, if any, and any determination or interpretations, made by the Committee shall be final, binding and conclusive. Any adjustment made under this Section 11 will be made in accordance with any required action by shareholders of the Company, the provisions of any applicable corporate law and the approval of the required majority, as defined in Section 57(o) of the 1940 Act, of the Company’s directors. Conversion of any convertible securities of the Company shall not be deemed to have been effected without receipt of consideration. Except as expressly provided herein, no issuance by the Company of shares of

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any class or securities convertible into shares of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares subject to a Restricted Stock Award.

(b) Change in Control. If a Change in Control occurs, the Committee may, in its discretion and subject to the limitations set forth in Section 6(d) of the Plan:

(i) Cancel outstanding Restricted Stock Awards in exchange for payments of cash, property or a combination thereof having an aggregate value equal to the value of such Restricted Stock Awards, as determined by the Committee or the Board of Directors in its sole discretion;

(ii) Substitute other property (including, without limitation, cash or other securities of the Company and securities of entities other than the Company) for Shares subject to outstanding Restricted Stock Awards; and

(iii) Arrange for the assumption of Restricted Stock Awards, or replacement of Restricted Stock Awards with new awards based on other property or other securities (including, without limitation, other securities of the Company and securities of entities other than the Company), by the affected Subsidiary, Affiliate, or division or by the entity that controls such Subsidiary, Affiliate, or division following the transaction (as well as any corresponding adjustments to Restricted Stock Awards that remain outstanding based upon Company securities);

No such adjustments may, however, change the vesting schedule for an outstanding Restricted Stock Award upon a Change in Control or otherwise change the value of benefits available to a Participant under an outstanding Restricted Stock Award.

## 12. TAX WITHHOLDING

The Company's obligation to make cash payments pursuant to a Restricted Stock Award or deliver Shares, or any other event with respect to rights and benefits hereunder, shall be subject to the Participant's satisfaction of all applicable federal, state and local income and employment tax withholding obligations. To the extent that the Company is required to withhold any federal, state or local income and employment taxes in respect of any compensation income realized by the Participant in respect of Shares acquired pursuant to a Restricted Stock Award, or in respect of any Shares becoming vested, then the Company shall deduct from any payments of any kind otherwise due to such Participant the aggregate amount of such federal, state or local income and employment taxes required to be so withheld. If no such payments are due or become due to such Participant, or if such payments are insufficient to satisfy such federal, state or local income or employment taxes, then such Participant will be required to pay to the Company, or make other arrangements satisfactory to the Company regarding payment to the Company of, the aggregate amount of any such taxes. The Committee, in its discretion, may permit the Participant to satisfy the obligation, in whole or in part, by irrevocably electing to have the Company withhold Shares, or to deliver to the Company Shares that he or she already owns, having a value equal to the amount required to be withheld. The value of the Shares to be withheld, or delivered to the Company, shall be based on the Fair Market Value of Shares on the date the amount of tax to be withheld is determined. In no event will the Fair Market Value of Shares to be withheld and delivered pursuant to this Section 12 exceed the minimum amount required to be withheld, unless (a) an additional amount can be withheld and not result in adverse accounting consequences, (b) such additional withholding amount is authorized by the Committee, and (c) the total amount withheld does not exceed the Participant's estimated tax obligations attributable to the applicable transaction. As an alternative, the Company may retain, or sell without notice, a number of such Shares sufficient to cover the amount required to be withheld.

## 13. AMENDMENT OF THE PLAN AND RESTRICTED STOCK AWARDS

(a) The Board of Directors may at any time, and from time to time, modify or amend the Plan in any respect, prospectively or retroactively. Failure to ratify or approve amendments or modifications by shareholders shall be effective only as to the specific amendment or modification requiring such approval or ratification. Other provisions of this Plan will remain in full force and effect. No such termination, modification or amendment may adversely affect the rights of a Participant under an outstanding Restricted Stock Award without the written permission of such Participant.





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(b) The Committee may amend any Award Agreement, prospectively or retroactively; provided, however, that no such amendment shall adversely affect the rights of any Participant under an outstanding Restricted Stock Award without the written consent of such Participant.

14. RIGHT OF OFFSET

The Company will have the right to offset against its obligation to deliver Shares (or other property) under the Plan or any Award Agreement any outstanding amounts (including, without limitation, travel and entertainment or advance account balances, loans, repayment obligations under any Restricted Stock Awards, or amounts repayable to the Company pursuant to tax equalization, housing, automobile or other employee programs) that the Participant then owes to the Company and any amounts the Committee otherwise deems appropriate pursuant to any tax equalization policy or agreement. This right of offset shall not be an exclusive remedy and the Company's election not to exercise the right of offset with respect to any amount payable to a Participant shall not constitute a waiver of this right of offset with respect to any other amount payable to the Participant or any other remedy.

15. DETRIMENTAL ACTIVITY AND RECAPTURE PROVISIONS.

Any Award Agreement may reference a clawback policy of the Company or provide for the cancellation or forfeiture of an award or the forfeiture and repayment to the Company of any gain related to an award, or other provisions intended to have a similar effect, upon such terms and conditions as may be determined by the Committee from time to time, if a Participant, either (a) during employment or other service with the Company Group or (b) within a specified period after termination of such employment or service, engages in any detrimental activity, as described in the applicable Award Agreement or such clawback policy. In addition, notwithstanding anything in this Plan to the contrary, any Award Agreement or such clawback policy may also provide for the cancellation or forfeiture of an award or the forfeiture and repayment to the Company of any Shares issued under and/or any other benefit related to an award, or other provisions intended to have a similar effect, upon such terms and conditions as may be required by the Committee or under Section 10D of the Exchange Act and any applicable rules or regulations promulgated by the Securities and Exchange Commission, the NASDAQ or any national securities exchange or national securities association on which the Shares may be traded.

16. EFFECTIVE DATE OF PLAN

The Plan shall become effective immediately upon its approval by the Company's shareholders.

17. TERMINATION OF THE PLAN

The right to grant Restricted Stock Awards under the Plan will terminate 10 years after the Effective Date. The Board of Directors has the right to suspend or terminate the Plan at any time, provided that no such action will, without the consent of a Participant, adversely affect a Participant's rights under an outstanding Restricted Stock Award.

18. APPLICABLE LAW; COMPLIANCE WITH LAWS

(a) The Plan will be administered in accordance with the laws of the State of Texas and applicable federal law. Notwithstanding any other provision of the Plan, the Company shall have no liability to issue any Shares under the Plan unless such issuance would comply with all applicable laws and the applicable requirements of any securities exchange or similar entity. Prior to the issuance of any Shares under the Plan, the Company may require a written statement that the recipient is acquiring the shares for investment and not for the purpose or with the intention of distributing the shares.

(b) It is the intention of the Company that no Restricted Stock Award shall be "deferred compensation" subject to Code Section 409A, and the Plan and the terms and conditions of all Restricted Stock Awards shall be interpreted accordingly.

(c) Notwithstanding anything in this Plan or an Award Agreement to the contrary, nothing in this Plan or in an Award Agreement prevents a Participant from providing, without prior notice to the Company, information to



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governmental authorities regarding possible legal violations or otherwise testifying or participating in any investigation or proceeding by any governmental authorities regarding possible legal violations, and for purpose of clarity, a Participant is not prohibited from providing information voluntarily to the Securities and Exchange Commission pursuant to Section 21F of the Exchange Act.

**19. NO GRANTS IN CONTRAVENTION OF THE 1940 ACT**

(a) At all times during such periods as the Company qualifies or intends to qualify as a “business development company,” no Restricted Stock Award may be granted under the Plan if the grant or terms of such Restricted Stock Award would cause the Company to violate Section 61 of the 1940 Act (or any other provision of the 1940 Act applicable to “business development companies”), and, if approved for grant, such an award will be void and of no effect.

(b) In furtherance of the intent that Restricted Stock Awards available to be granted under the Plan be limited to those that can be granted by a “business development company” qualifying as such under the 1940 Act, except as otherwise permitted by exemptive relief or other relief that may be granted by the Securities and Exchange Commission or its staff and determined by the Board of Directors, Restricted Stock may be awarded only in exchange for full payment thereof (as determined by the Board of Directors).

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VOTE BY INTERNET - [www.proxyvote.com](http://www.proxyvote.com)

Use the Internet to transmit your voting instructions and for electronic delivery of information. Vote by 11:59 P.M. ET on 08/01/2018 for shares held directly and by 11:59 P.M. ET on 07/30/2018 for shares held in a Plan. Have your proxy card in hand when you access the web site and follow the instructions to obtain your records and to create an electronic voting instruction form.

CAPITAL SOUTHWEST  
CORPORATION  
ATTN: ALLY BENSON  
5400 LBJ FREEWAY, SUITE 1300  
DALLAS, TX 75240

ELECTRONIC DELIVERY OF FUTURE PROXY MATERIALS

If you would like to reduce the costs incurred by our company in mailing proxy materials, you can consent to receiving all future proxy statements, proxy cards and annual reports electronically via e-mail or the Internet. To sign up for electronic delivery, please follow the instructions above to vote using the Internet and, when prompted, indicate that you agree to receive or access proxy materials electronically in future years.

VOTE BY PHONE - 1-800-690-6903

Use any touch-tone telephone to transmit your voting instructions. Vote by 11:59 P.M. ET on 08/01/2018 for shares held directly and by 11:59 P.M. ET on 07/30/2018 for shares held in a Plan. Have your proxy card in hand when you call and then follow the instructions.

VOTE BY MAIL

Mark, sign and date your proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

KEEP THIS PORTION FOR YOUR RECORDS  
DETACH AND RETURN THIS PORTION ONLY

THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.

The Board of Directors recommends you vote FOR the following:	For All Withhold All For All To withhold authority to vote for any individual nominee(s), mark "For All Except" and write the number(s) of the nominee(s) on the line below.
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1. Election of Directors

Nominees

- |  |                   |                  |                    |
|--|-------------------|------------------|--------------------|
| 01 <del>Christine</del> David R. S. Brooks Battist<br>02<br>06 <del>William</del> John H. R. Wilson Thomas III | 03 Bowen S. Diehl | 04 Jack D. Furst | 05 T. Duane Morgan |
|--|-------------------|------------------|--------------------|

The Board of Directors recommends you vote FOR proposals 2, 3 and 4. For Against

2 Proposal to approve the Capital Southwest Corporation Amended and Restated 2010 Restricted Stock Award Plan.

3 Proposal to approve, on an advisory basis, executive compensation.

4 Proposal to ratify the appointment by our Audit Committee of RSM US LLP as our independent registered public accounting firm for the fiscal year ending March 31, 2019.

NOTE: Such other business as may properly come before the meeting or any adjournment thereof.

Please sign exactly as your name(s) appear(s) hereon. When signing as attorney, executor, administrator, or other fiduciary, please give full title as such. Joint owners should each sign personally. All holders must sign. If a corporation or partnership, please sign in full corporate or partnership name by authorized officer.

Signature	Date	Signature (Joint Owners)	Date
[PLEASE SIGN WITHIN BOX]			

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Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting: The Notice & Proxy Statement, Form 10-K is/are available at [www.proxyvote.com](http://www.proxyvote.com)

CAPITAL SOUTHWEST CORPORATION

Annual Meeting of Shareholders

August 2, 2018 9:00 AM

This proxy is solicited by the Board of Directors

The shareholders hereby appoint Michael S. Sarnier and Ally Benson, or either of them, as proxies, each with the power to appoint (his/her) substitute, and hereby authorizes them to represent and to vote, as designated on the reverse side of this ballot, all of the shares of Common stock of Capital Southwest Corporation, that the shareholders is/are entitled to vote at the Annual Meeting of shareholders to be held at 9:00 AM, CDT on August 2nd, 2018, at the Hilton Dallas Lincoln Centre located at 5410 LBJ Freeway, Dallas, Texas 75240, and any adjournment or postponement thereof.

This proxy, when properly executed, will be voted in the manner directed herein. If no such direction is made, this proxy will be voted in accordance with the Board of Directors' recommendations.

Continued and to be signed on reverse side

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