NuStar Energy L.P.
Form 10-Q
May 05, 2011

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2011

OR

o 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 1-16417

NUSTAR ENERGY L.P.
(Exact name of registrant as specified in its charter)

Delaware	74-2956831
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2330 North Loop 1604 West San Antonio, Texas	78248
(Address of principal executive offices)	(Zip Code)

Registrant’s telephone number, including area code (210) 918-2000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

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 Rule12b-2 of the Exchange Act:

Large accelerated filer	x	Accelerated filer	£
Non-accelerated filer	o (Do not check if a smaller reporting company)	Smaller reporting company	£

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

The number of common units outstanding as of April 30, 2011 was 64,610,549.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Thousands of Dollars, Except Unit Data)

	March 31, 2011 (Unaudited)	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$70,437	$181,121
Accounts receivable, net of allowance for doubtful accounts of $1,353 and $1,457 as of March 31, 2011 and December 31, 2010, respectively	397,252	302,053
Inventories	598,830	413,537
Other current assets	64,605	42,796
Total current assets	1,131,124	939,507
Property, plant and equipment, at cost	4,134,010	4,021,319
Accumulated depreciation and amortization	(873,758)	(833,862)
Property, plant and equipment, net	3,260,252	3,187,457
Intangible assets, net	60,369	43,033
Goodwill	843,294	813,270
Investment in joint venture	69,068	69,603
Deferred income tax asset	7,683	8,138
Other long-term assets, net	293,430	325,385
Total assets	$5,665,220	$5,386,393
Liabilities and Partners' Equity		
Current liabilities:		
Current portion of long-term debt	$832	$832
Accounts payable	359,046	282,382
Payable to related party	12,182	10,345
Accrued interest payable	23,638	29,706
Accrued liabilities	53,007	57,953
Taxes other than income tax	9,904	10,718
Income tax payable	2,741	1,293
Total current liabilities	461,350	393,229
Long-term debt, less current portion	2,361,464	2,136,248
Long-term payable to related party	10,733	10,088
Deferred income tax liability	34,404	29,565
Other long-term liabilities	118,686	114,563
Commitments and contingencies (Note 4)		
Partners' equity:		
Limited partners (64,610,549 common units outstanding as of March 31, 2011 and December 31, 2010)	2,548,953	2,598,873
General partner	56,133	57,327
Accumulated other comprehensive income	57,931	46,500
Total NuStar Energy L.P. partners' equity	2,663,017	2,702,700

Noncontrolling interest	15,566	—
Total partners' equity	2,678,583	2,702,700
Total liabilities and partners' equity	$5,665,220	$5,386,393

See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, Thousands of Dollars, Except Unit and Per Unit Data)

	Three Months Ended March 31,	
	2011	2010
Revenues:		
Service revenues:		
Third parties	$198,263	$189,295
Related party	130	—
Total service revenues	198,393	189,295
Product sales	1,036,223	756,234
Total revenues	1,234,616	945,529
Costs and expenses:		
Cost of product sales	992,367	719,221
Operating expenses:		
Third parties	85,130	87,493
Related party	35,109	33,844
Total operating expenses	120,239	121,337
General and administrative expenses:		
Third parties	9,035	10,031
Related party	16,948	17,238
Total general and administrative expenses	25,983	27,269
Depreciation and amortization expense	40,296	37,929
Total costs and expenses	1,178,885	905,756
Operating income	55,731	39,773
Equity in earnings of joint venture	2,388	3,015
Interest expense, net	(20,457)	(18,586)
Other (expense) income, net	(5,499)	301
Income before income tax expense	32,163	24,503
Income tax expense	3,647	4,800
Net income	28,516	19,703
Less net income attributable to noncontrolling interest	14	—
Net income attributable to NuStar Energy L.P.	$28,502	$19,703
Net income per unit applicable to limited partners (Note 10)	$0.30	$0.19
Weighted average limited partner units outstanding	64,610,549	60,210,549

See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, Thousands of Dollars)

	Three Months Ended March 31,	
	2011	2010
Cash Flows from Operating Activities:		
Net income	$28,516	$19,703
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	40,296	37,929
Amortization of debt related items	(1,973)	(1,908)
Deferred income tax (benefit) expense	(551)	616
Equity in earnings of joint venture	(2,388)	(3,015)
Distributions of equity in earnings of joint venture	2,923	2,400
Changes in current assets and current liabilities (Note 11)	(232,899)	(18,426)
Other, net	278	(50)
Net cash (used in) provided by operating activities	(165,798)	37,249
Cash Flows from Investing Activities:		
Reliability capital expenditures	(7,372)	(11,259)
Strategic capital expenditures	(65,874)	(44,779)
Acquisition	(52,577)	—
Investment in other long-term assets	(636)	(1,096)
Other, net	58	112
Net cash used in investing activities	(126,401)	(57,022)
Cash Flows from Financing Activities:		
Proceeds from long-term debt borrowings	343,680	306,355
Proceeds from short-term debt borrowings	31,600	91,712
Long-term debt repayments	(82,394)	(229,871)
Short-term debt repayments	(31,600)	(111,712)
Distributions to unitholders and general partner	(79,616)	(73,392)
Decrease in cash book overdrafts	(529)	(4,622)
Other, net	(615)	(75)
Net cash provided by (used in) financing activities	180,526	(21,605)
Effect of foreign exchange rate changes on cash	989	(478)
Net decrease in cash and cash equivalents	(110,684)	(41,856)
Cash and cash equivalents as of the beginning of the period	181,121	62,006
Cash and cash equivalents as of the end of the period	$70,437	$20,150

See Condensed Notes to Consolidated Financial Statements.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

Organization

NuStar Energy L.P. (NuStar Energy) (NYSE: NS) is engaged in the terminalling and storage of petroleum products, the transportation of petroleum products and anhydrous ammonia, and asphalt refining and fuels marketing. Unless otherwise indicated, the terms "NuStar Energy," "the Partnership," "we," "our" and "us" are used in this report to refer to NuSt Energy L.P., to one or more of our consolidated subsidiaries or to all of them taken as a whole. NuStar GP Holdings, LLC (NuStar GP Holdings) (NYSE: NSH) owns our general partner, Riverwalk Logistics, L.P., and owns a 17.6% total interest in us as of March 31, 2011.

We conduct our operations through our subsidiaries, primarily NuStar Logistics, L.P. (NuStar Logistics) and NuStar Pipeline Operating Partnership L.P. (NuPOP). We have three business segments: storage, transportation, and asphalt and fuels marketing.

Basis of Presentation

These unaudited consolidated financial statements include the accounts of the Partnership and subsidiaries in which the Partnership has a controlling interest. Intercompany balances and transactions have been eliminated in consolidation. We account for investments in 50% or less-owned entities using the equity method. Noncontrolling interests are separately disclosed on the consolidated balance sheets and consolidated statements of income.

These unaudited consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and notes required by GAAP for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included and all disclosures made are adequate. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three months ended March 31, 2011 and 2010 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited consolidated financial statements. Operating results for the three months ended March 31, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The consolidated balance sheet as of December 31, 2010 has been derived from the audited consolidated financial statements as of that date. These unaudited consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2010.

Acquisition

On February 9, 2011, we acquired 75% of a company for approximately $54.0 million, excluding working capital of $2.4 million (Turkey Acquisition). The acquired company owns two terminals located in Mersin, Turkey with an aggregate 44 storage tanks and 1.3 million barrels of storage capacity. Both terminals are connected via pipelines to an offshore platform located approximately three miles off the Mediterranean Sea coast. The purchase price has been preliminarily allocated based on the estimated fair values of the individual assets acquired and liabilities assumed at the date of acquisition pending completion of an independent appraisal and other evaluations. The consolidated statements of income include the results of operations for the Turkey Acquisition commencing on February 9, 2011, with 25% accounted for as a noncontrolling interest.

2. INVENTORIES

Inventories consisted of the following:

	March 31, 2011	December 31, 2010
	(Thousands of Dollars)	
Crude oil	$147,738	$122,945
Finished products	441,530	281,197
Materials and supplies	9,562	9,395
Total	$598,830	$413,537

3. DEBT

Revolving Credit Agreement

During the three months ended March 31, 2011, we borrowed an aggregate $310.0 million under our $1.2 billion five-year revolving credit agreement (the 2007 Revolving Credit Agreement) to fund a portion of our capital expenditures and working capital requirements. Additionally, we repaid $82.4 million during the three months ended March 31, 2011. The 2007 Revolving Credit Agreement bears interest based on either an alternative base rate or a LIBOR based rate. As of March 31, 2011, our weighted average borrowing interest rate was 0.9%, and we had $501.9 million available for borrowing under the 2007 Revolving Credit Agreement. Due to a covenant in our 2007 Revolving Credit Agreement that requires us to maintain, as of the end of each four consecutive fiscal quarters, a consolidated debt coverage ratio not to exceed 5.00-to-1.00, we may not be able to borrow the maximum available amount. On March 7, 2011, we amended the 2007 Revolving Credit Agreement to exclude unused proceeds from the Gulf Opportunity Zone bond issuances from total indebtedness in the calculation of the consolidated debt coverage ratio. As of March 31, 2011, our consolidated debt coverage ratio was 4.4x.

Gulf Opportunity Zone Revenue Bonds

The Parish of St. James, Louisiana issued three separate series of tax exempt revenue bonds in 2010 (2010 GoZone) associated with our St. James terminal expansion pursuant to the Gulf Opportunity Zone Act of 2005. The interest rate on these bonds is based on a weekly tax-exempt bond market interest rate, and interest is paid monthly. The interest rate was 0.2% as of March 31, 2011. Following the issuance, the proceeds were deposited with a trustee and will be disbursed to us upon our request for reimbursement of expenditures related to our St. James terminal expansion. The amount remaining in trust related to the 2010 GoZone is included in “Other long-term assets, net,” and the amount of bonds issued is included in “Long-term debt, less current portion” in our consolidated balance sheets. For the three months ended March 31, 2011, we received net proceeds of $33.7 million from the 2010 GoZone. The amount remaining in trust as of March 31, 2011 totaled $171.7 million.

Lines of Credit

As of March 31, 2011, we had one short-term line of credit with an uncommitted borrowing capacity of up to $20.0 million. We had no outstanding borrowings on this line of credit as of March 31, 2011. During the three months ended March 31, 2011, we borrowed and repaid $31.6 million related to this line of credit.

4. COMMITMENTS AND CONTINGENCIES

Contingencies

We have contingent liabilities resulting from various litigation, claims and commitments, the most significant of which are discussed below. We record accruals for loss contingencies when losses are considered probable and can be reasonably estimated. Legal fees associated with defending the Partnership in legal matters are expensed as incurred. As of March 31, 2011, we have accrued $73.3 million for contingent losses. The amount that will ultimately be paid related to these matters may differ from the recorded accruals, and the timing of such payments is uncertain.

Grace Energy Corporation Matter. In 1997, Grace Energy Corporation (Grace Energy) sued subsidiaries of Kaneb Pipeline Partners, L.P. (KPP) and Kaneb Services LLC (KSL and collectively with KPP and their respective subsidiaries, Kaneb) in Texas state court. We acquired Kaneb on July 1, 2005. The complaint sought recovery of the cost of remediation of fuel leaks in the 1970s from a pipeline that had once connected a former Grace Energy terminal with Otis Air Force Base in Massachusetts (Otis AFB). Grace Energy alleges the Otis AFB pipeline and related environmental liabilities had been transferred in 1978 to an entity that was part of Kaneb's acquisition of Support

Terminal Services, Inc. and its subsidiaries from Grace Energy in 1993. Kaneb contends that it did not acquire the Otis AFB pipeline and never assumed any responsibility for any associated environmental damage.

In 2000, the court entered final judgment that: (i) Grace Energy could not recover its own remediation costs of $3.5 million, (ii) Kaneb owned the Otis AFB pipeline and its related environmental liabilities and (iii) Grace Energy was awarded $1.8 million in attorney costs. Both Kaneb and Grace Energy appealed the final judgment of the trial court to the Texas Court of Appeals in Dallas. In 2001, Grace Energy filed a petition in bankruptcy, which created an automatic stay of actions against Grace Energy. In September 2008, Grace Energy filed its Joint Plan of Reorganization and Disclosure Statement.

The Otis AFB is a part of a Superfund Site pursuant to the Comprehensive Environmental Response Compensation and Liability Act (CERCLA). The site contains a number of groundwater contamination plumes, two of which are allegedly associated with the Otis AFB pipeline. Relying on the final judgment of the Texas state court assigning ownership of the Otis AFB pipeline to Kaneb, the United States Department of Justice (the DOJ) advised Kaneb in 2001 that it intends to seek reimbursement from Kaneb for the remediation costs associated with the two plumes. In November 2008, the DOJ forwarded information to us indicating that the past and estimated future remediation expenses associated with one plume are $71.9 million. The DOJ has indicated that they will not seek recovery of remediation costs for the second plume. The DOJ has not filed a lawsuit against us related to this matter, and we have not made any payments toward costs incurred by the DOJ. We are currently in settlement discussions with other potentially responsible parties and the DOJ, and a change in our estimate of this liability may occur in the near term. However, any settlement agreement that is reached must be approved by multiple parties and requires the approval of the bankruptcy court and the federal district court. We cannot currently estimate when or if a settlement will be finalized.

Eres Matter. In August 2008, Eres N.V. (Eres) forwarded a demand for arbitration to CITGO Asphalt Refining Company (CARCO), CITGO Petroleum Corporation (CITGO), NuStar Asphalt Refining, LLC (NuStar Asphalt) and NuStar Marketing LLC (NuStar Marketing, and together with CARCO, CITGO and NuStar Asphalt, the Defendants) contending that the Defendants are in breach of a tanker voyage charter party agreement, dated November 2004, between Eres and CARCO (the Charter Agreement). The Charter Agreement provides for CARCO's use of Eres' vessels for the shipment of asphalt. Eres contends that NuStar Asphalt and/or NuStar Marketing (together, the NuStar Entities) assumed the Charter Agreement when NuStar Asphalt purchased the CARCO assets, and that the Defendants have failed to perform under the Charter Agreement since January 1, 2008. Eres has valued its damages for the alleged breach of contract claim at approximately $78.1 million. Pursuant to a May 2010 ruling by the United States District Court for the Southern District of Texas, the NuStar Entities were found to have assumed the Charter Agreement from CARCO and to be obligated to defend and indemnify CITGO and CARCO against Eres' claims. The Defendants were ordered to proceed with arbitration. We intend to vigorously defend against Eres' claims in arbitration.

Other. We are also a party to additional claims and legal proceedings arising in the ordinary course of business. Due to the inherent uncertainty of litigation, there can be no assurance that the resolution of any particular claim or proceeding would not have a material adverse effect on our results of operations, financial position or liquidity. It is possible that if one or more of the matters described above were decided against us, the effects could be material to our results of operations in the period in which we would be required to record or adjust the related liability and could also be material to our cash flows in the periods we would be required to pay such liability.

5. FAIR VALUE MEASUREMENTS

We segregate the inputs used in measuring fair value into three levels: Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists. The following assets and liabilities are measured at fair value:

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$1,025	$—	$—	$1,025
Commodity derivatives	14,472	—	—	14,472
Other long-term assets, net:				
Interest rate swaps	—	46,864	—	46,864
Accrued liabilities:				
Product imbalances	(379)	—	—	(379)
Commodity derivatives	(27,872)	—	—	(27,872)

Other long-term liabilities:				
Interest rate swaps	—	(33,721)	—	(33,721)
Total	$(12,754)	$13,143	$—	$389

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December 31, 2010	
Level 1	Level 2