

NuStar Energy L.P.
Form 10-Q
August 07, 2018

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

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 1-16417

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.)

19003 IH-10 West 78257
San Antonio, Texas (Zip Code)
(Address of principal executive offices)
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 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:

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

The number of common units outstanding as of July 31, 2018 was 107,042,618.

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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)

	June 30, 2018 (Unaudited)	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	\$20,344	\$24,292
Accounts receivable, net of allowance for doubtful accounts of \$10,419 and \$9,948 as of June 30, 2018 and December 31, 2017, respectively	141,872	176,570
Receivable from related party	279	205
Inventories	28,071	26,857
Other current assets	26,526	22,508
Total current assets	217,092	250,432
Property, plant and equipment, at cost	6,514,589	6,243,481
Accumulated depreciation and amortization	(2,054,908)	(1,942,548)
Property, plant and equipment, net	4,459,681	4,300,933
Intangible assets, net	758,767	784,479
Goodwill	1,094,661	1,097,475
Deferred income tax asset	—	233
Other long-term assets, net	116,768	101,681
Total assets	\$6,646,969	\$6,535,233
Liabilities, Mezzanine Equity and Partners' Equity		
Current liabilities:		
Accounts payable	\$127,801	\$145,932
Short-term debt	63,000	35,000
Current portion of long-term debt	—	349,990
Accrued interest payable	36,192	40,449
Accrued liabilities	64,719	61,578
Taxes other than income tax	16,220	14,385
Income tax payable	3,357	4,172
Total current liabilities	311,289	651,506
Long-term debt, less current portion	3,380,366	3,263,069
Deferred income tax liability	23,113	22,272
Other long-term liabilities	105,013	118,297
Total liabilities	3,819,781	4,055,144
Commitments and contingencies (Note 6)		
Series D preferred limited partners (15,760,441 preferred units outstanding as of June 30, 2018) (Note 11)	370,711	—
Partners' equity (Note 12):		
	756,334	756,603

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Preferred limited partners (9,060,000 Series A preferred units, 15,400,000 Series B preferred units and 6,900,000 Series C preferred units outstanding as of June 30, 2018 and December 31, 2017)

Common limited partners (93,597,181 and 93,176,683 common units outstanding as of June 30, 2018 and December 31, 2017, respectively)

General partner

Accumulated other comprehensive loss

Total partners' equity

Total liabilities, mezzanine equity and partners' equity

See Condensed Notes to Consolidated Financial Statements.

1,740,768 1,770,587

25,999 37,826

(66,624) (84,927)

2,456,477 2,480,089

\$6,646,969 \$6,535,233

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Service revenues	\$302,131	\$283,700	\$593,544	\$550,162
Product sales	184,073	151,788	368,541	372,756
Total revenues	486,204	435,488	962,085	922,918
Costs and expenses:				
Costs associated with service revenues:				
Operating expenses (excluding depreciation and amortization expense)	131,672	116,400	240,556	217,426
Depreciation and amortization expense	73,613	65,402	143,510	120,073
Total costs associated with service revenues	205,285	181,802	384,066	337,499
Cost of product sales	170,849	144,479	347,577	352,285
General and administrative expenses (excluding depreciation and amortization expense)	27,981	33,604	47,755	58,199
Other depreciation and amortization expense	2,251	2,199	4,369	4,392
Total costs and expenses	406,366	362,084	783,767	752,375
Operating income	79,838	73,404	178,318	170,543
Interest expense, net	(48,936)	(45,612)	(96,708)	(82,026)
Other income, net	1,412	88	81,164	228
Income before income tax expense	32,314	27,880	162,774	88,745
Income tax expense	2,915	1,630	7,242	4,555
Net income	\$29,399	\$26,250	\$155,532	\$84,190
Basic net income per common unit (Note 14)	\$0.15	\$0.05	\$1.30	\$0.51
Basic weighted-average common units outstanding	93,192,238	90,345,469	93,187,038	84,526,506
Comprehensive income	\$26,778	\$27,381	\$173,835	\$89,084
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)

	Six Months Ended June 30, 2018		2017
Cash Flows from Operating Activities:			
Net income	\$ 155,532		\$ 84,190
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	147,879		124,465
Unit-based compensation expense	4,277		5,117
Amortization of debt related items	3,965		3,146
Gain from sale or disposition of assets	(1,218)		(36)
Gain from insurance recoveries	(78,756)		—
Deferred income tax expense	1,142		23
Changes in current assets and current liabilities (Note 15)	42,733		(15,344)
(Increase) decrease in other long-term assets	(11,224)		2,698
(Decrease) increase in other long-term liabilities	(20,073)		5,494
Other, net	(407)		(765)
Net cash provided by operating activities	243,850		208,988
Cash Flows from Investing Activities:			
Capital expenditures	(248,521)		(108,849)
Change in accounts payable related to capital expenditures	(19,320)		6,851
Proceeds from sale or disposition of assets	2,097		1,966
Proceeds from Axeon term loan	—		110,000
Proceeds from insurance recoveries	78,419		—
Acquisitions	(37,502)		(1,476,719)

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Net cash used in investing activities	(224,827))	(1,466,751))
Cash Flows from Financing Activities:				
Proceeds from long-term debt borrowings	677,272		1,037,161	
Proceeds from short-term debt borrowings	456,000		565,000	
Proceeds from note offering, net of issuance costs	—		543,313	
Long-term debt repayments	(905,521))	(1,122,239))
Short-term debt repayments	(428,000))	(574,000))
Proceeds from issuance of Series D preferred units	400,000		—	
Payment of issuance costs for Series D preferred units	(29,289))	—	
Proceeds from issuance of other preferred units, net of issuance costs	—		371,802	
Proceeds from issuance of common units, net of issuance costs	10,000		643,858	
Contributions from general partner	—		13,597	
Distributions to preferred unitholders	(32,713))	(10,696))
Distributions to common unitholders and general partner	(172,324))	(216,139))
Proceeds from termination of interest rate swaps	8,048		—	
(Decrease) increase in cash book overdrafts	(436))	1,321	
Other, net	(5,587))	(2,615))
Net cash (used in) provided by financing activities	(22,550))	1,250,363	
Effect of foreign exchange rate changes on cash	(421))	649	
	(3,948))	(6,751))

Net decrease in cash and cash equivalents		
Cash and cash equivalents as of the beginning of the period	24,292	35,942
Cash and cash equivalents as of the end of the period	\$ 20,344	\$ 29,191

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 and Operations

NuStar Energy L.P. (NYSE: NS) is a publicly held Delaware limited partnership engaged in the transportation of petroleum products and anhydrous ammonia, and the terminalling, storage and marketing of petroleum products. Unless otherwise indicated, the terms “NuStar Energy,” “NS,” “the Partnership,” “we,” “our” and “us” are used in this report to refer to NuStar Energy L.P., to one or more of our consolidated subsidiaries or to all of them taken as a whole. As of June 30, 2018, NuStar GP Holdings, LLC (NuStar GP Holdings or NSH) owned our general partner, Riverwalk Logistics, L.P., and an approximate 11% common limited partner interest in us. As a result of the merger described below, NSH became a wholly owned subsidiary of ours on July 20, 2018.

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: pipeline, storage and fuels marketing.

Recent Developments

Merger. On July 20, 2018, we completed the merger of NSH with a subsidiary of NS. Under the terms of the merger agreement, NSH unitholders are entitled to receive 0.55 of a common unit representing a limited partner interest in NS in exchange for each NSH unit owned at the effective time of the merger. See Note 2 for further discussion of the merger.

Issuance of units. On June 29, 2018, we issued 15,760,441 Series D Cumulative Convertible Preferred Units (Series D Preferred Units) at a price of \$25.38 per unit in a private placement for net proceeds of \$370.7 million. On July 13, 2018, we issued an additional 7,486,209 Series D Preferred Units at a price of \$25.38 per unit in a private placement for net proceeds of \$185.2 million. See Note 11 for further discussion. On June 29, 2018, we issued 413,736 common units at a price of \$24.17 per unit to William E. Greehey, Chairman of the Board of Directors of NuStar GP, LLC.

Hurricane Activity. In the third quarter of 2017, several of our facilities were affected by the hurricanes in the Caribbean and Gulf of Mexico, including our St. Eustatius terminal, which experienced the most damage and was temporarily shut down. The damage caused by the Caribbean hurricane resulted in lower revenues for our bunker fuel operations in our fuels marketing segment and lower throughput and associated handling fees in our storage segment in 2017 and in the first quarter of 2018. In January 2018, we received \$87.5 million of insurance proceeds in settlement of our property damage claim for our St. Eustatius terminal, of which \$9.1 million related to business interruption. Proceeds from business interruption insurance are included in “Operating expenses” in the consolidated statements of income and in “Cash flows from operating activities” in the consolidated statements of cash flows. We recorded a \$78.8 million gain in “Other income, net” in the consolidated statements of income in the first quarter of 2018 for the amount by which the insurance proceeds exceeded our expenses incurred during the period. We expect that the costs to repair the property damage at the terminal will not exceed the amount of insurance proceeds received.

Basis of Presentation

These unaudited condensed consolidated financial statements include the accounts of the Partnership and subsidiaries in which the Partnership has a controlling interest. Inter-partnership balances and transactions have been eliminated in consolidation.

These unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and with the instructions to the Quarterly Report on 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 are adequate. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three and six months ended June 30, 2018 and 2017 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited condensed consolidated financial statements. Operating results for the three and six months ended June 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018. The consolidated balance sheet as of December 31, 2017 has been derived from the audited consolidated financial statements as of that date. These unaudited condensed 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, 2017.

Certain previously reported amounts in the 2017 consolidated financial statements have been reclassified to conform to the 2018 presentation.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

2. MERGER

On February 7, 2018, NuStar Energy, Riverwalk Logistics, L.P., NuStar GP, LLC, Marshall Merger Sub LLC, a wholly owned subsidiary of NuStar Energy (Merger Sub), Riverwalk Holdings, LLC and NuStar GP Holdings entered into an Agreement and Plan of Merger (the Merger Agreement). Pursuant to the Merger Agreement, Merger Sub merged with and into NuStar GP Holdings with NuStar GP Holdings being the surviving entity (the Merger), such that NuStar Energy is the sole member of NuStar GP Holdings following the Merger (refer to the next two pages for charts depicting our organizational structure before and after the Merger). The Merger closed on July 20, 2018. Pursuant to the Merger Agreement and at the effective time of the Merger, NuStar Energy's partnership agreement was amended and restated to, among other things, (i) cancel the incentive distribution rights held by our general partner, (ii) convert the 2% general partner interest in NuStar Energy held by our general partner into a non-economic management interest and (iii) provide the holders of our common units with voting rights in the election of the members of the board of directors of NuStar GP, LLC at an annual meeting, beginning in 2019.

At the effective time of the Merger, each outstanding NuStar GP Holdings common unit was converted into the right to receive 0.55 of a NuStar Energy common unit and all NuStar GP Holdings common units ceased to be outstanding. No fractional NuStar Energy common units were issued in the Merger; instead, each holder of NuStar GP Holdings' common units otherwise entitled to receive a fractional NuStar Energy common unit is receiving cash in lieu thereof. As a result of the Merger, we issued approximately 23.6 million NuStar Energy common units and cancelled the 10.2 million NuStar Energy common units owned by subsidiaries of NuStar GP Holdings, resulting in approximately 13.4 million incremental NuStar Energy common units outstanding after the Merger.

Also at the effective time of the Merger, each outstanding award of NuStar GP Holdings restricted units was converted, on the same terms and conditions as were applicable to the awards immediately prior to the Merger, into an award of NuStar Energy restricted units. The number of NuStar Energy restricted units subject to the converted awards was determined pursuant to the 0.55 exchange ratio provided in the Merger Agreement.

Following the completion of the Merger, the NuStar GP, LLC board of directors consists of nine members, currently composed of the six members of the NuStar GP, LLC board of directors prior to the Merger and the three independent directors who served prior to the Merger on NuStar GP Holdings' board of directors.

We plan to account for the Merger as an equity transaction similar to a redemption or induced conversion of preferred stock. The excess of (1) the fair value of the consideration transferred in exchange for the outstanding NSH units over (2) the carrying value of the general partner interest in the Partnership will be subtracted from net income available to common unitholders in the calculation of net income per unit. The consideration transferred includes the fair value of the incremental NS units issued, assumed NSH debt of \$51.5 million and estimated transaction costs of approximately \$10.0 million, resulting in an estimated reduction of \$3.55 per common unit in the third quarter of 2018.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following chart depicts a summary of our organizational structure at June 30, 2018, before the Merger:

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NUSTAR ENERGY L.P. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

The following chart depicts a summary of our organizational structure after the Merger:

3. NEW ACCOUNTING PRONOUNCEMENTS

Unit-Based Payments to Nonemployees

In June 2018, the Financial Accounting Standards Board (FASB) issued amended guidance which aligns the measurement and classification guidance for unit-based payments to nonemployees with the guidance for unit-based payments to employees, with certain exceptions. Under the amended guidance, unit-based payment awards to nonemployees will be measured at their grant date fair value. The guidance is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. The amended guidance should be applied by means of a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption. We are currently evaluating whether we will adopt these provisions early, but we do not expect the guidance to have a material impact on our financial position, results of operations or disclosures.

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NUSTAR ENERGY L.P. AND SUBSIDIARIES

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

Comprehensive Income

In February 2018, the FASB issued amended guidance which provides an entity the option to reclassify stranded tax effects caused by the Tax Cuts and Jobs Act of 2017 from accumulated other comprehensive income to retained earnings, and also requires certain additional disclosures about those stranded tax effects. The guidance is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. The new requirements should be applied using one of two retrospective transition methods. We are currently evaluating whether we wil