MAGELLAN MIDSTREAM PARTNERS LP
Form 10-Q
August 02, 2013

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

FORM 10-Q

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

For the quarterly period ended June 30, 2013

OR

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

For the transition period from to

Commission File No.: 1-16335

Magellan Midstream Partners, L.P.
(Exact name of registrant as specified in its charter)

Delaware	73-1599053
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

One Williams Center, P.O. Box 22186, Tulsa, Oklahoma 74121-2186
(Address of principal executive offices and zip code)
(918) 574-7000
(Registrant’s telephone number, including area code)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company.

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

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

As of August 1, 2013, there were 226,679,438 outstanding limited partner units of Magellan Midstream Partners, L.P. that trade on the New York Stock Exchange under the ticker symbol "MMP."

Table of Contents

TABLE OF CONTENTS

PART I

FINANCIAL INFORMATION

1

Table of Contents

PART I
FINANCIAL INFORMATION

ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

MAGELLAN MIDSTREAM PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per unit amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Transportation and terminals revenue	$248,761	$282,462	$466,315	$509,733
Product sales revenue	200,568	157,922	476,298	359,633
Affiliate management fee revenue	198	3,528	397	6,967
Total revenue	449,527	443,912	943,010	876,333
Costs and expenses:				
Operating	82,326	77,415	150,778	142,596
Product purchases	144,498	115,328	393,110	275,726
Depreciation and amortization	31,486	34,186	62,996	70,518
General and administrative	25,414	33,262	49,158	63,318
Total costs and expenses	283,724	260,191	656,042	552,158
Earnings of non-controlled entities	1,478	736	3,126	2,787
Operating profit	167,281	184,457	290,094	326,962
Interest expense	29,118	31,720	58,241	63,443
Interest income	(29)	(13)	(64)	(35)
Interest capitalized	(1,028)	(3,243)	(1,892)	(6,694)
Debt placement fee amortization expense	518	540	1,037	1,080
Income before provision for income taxes	138,702	155,453	232,772	269,168
Provision for income taxes	881	1,813	1,427	2,561
Net income	$137,821	$153,640	$231,345	$266,607
Basic and diluted net income per limited partner unit	$0.61	$0.68	$1.02	$1.18
Weighted average number of limited partner units outstanding used for basic and diluted net income per unit calculation	226,429	226,864	226,305	226,785

See notes to consolidated financial statements.

Table of Contents

MAGELLAN MIDSTREAM PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited, in thousands)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Net income	$137,821	$153,640	$231,345	$266,607
Other comprehensive income:				
Net gain on interest rate cash flow hedges	1,008	—	1,008	—
Net gain (loss) on commodity cash flow hedges	1,667	—	1,667	(4,560)
Reclassification of net gain on interest rate cash flow hedges to interest expense(1)	(41)	(41)	(82)	(82)
Reclassification of net loss on commodity hedges to product sales revenue(1)	—	—	—	4,408
Changes in employee benefit plan assets and benefit obligations(2)	853	503	1,705	982
Total other comprehensive income	3,487	462	4,298	748
Comprehensive income	$141,308	$154,102	$235,643	$267,355

(1) See Note 8–Derivative Financial Instruments for additional information on amounts reclassified from accumulated other comprehensive loss into income.
(2) These accumulated other comprehensive income components are included in the computation of net periodic pension cost (see Note 6–Employee Benefit Plans).

See notes to consolidated financial statements.

Table of Contents

MAGELLAN MIDSTREAM PARTNERS, L.P.
CONSOLIDATED BALANCE SHEETS
(In thousands)

	December 31, 2012	June 30, 2013 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 328,278	$119,491
Trade accounts receivable (less allowance for doubtful accounts of $5 and $4 at December 31, 2012 and June 30, 2013, respectively)	91,114	86,676
Other accounts receivable	12,329	8,600
Inventory	221,888	207,904
Energy commodity derivatives contracts, net	—	4,364
Energy commodity derivatives deposits	18,304	11,078
Reimbursable costs	4,863	1,701
Other current assets	23,502	24,505
Total current assets	700,278	464,319
Property, plant and equipment	4,408,550	4,581,603
Less: accumulated depreciation	943,248	1,005,766
Net property, plant and equipment	3,465,302	3,575,837
Investments in non-controlled entities	107,356	207,758
Long-term receivables	5,135	2,881
Goodwill	53,260	53,260
Other intangibles (less accumulated amortization of $16,715 and $7,439 at December 31, 2012 and June 30, 2013, respectively)	13,274	8,659
Debt placement costs (less accumulated amortization of $7,886 and $8,966 at December 31, 2012 and June 30, 2013, respectively)	15,080	14,072
Tank bottom inventory	58,493	59,206
Other noncurrent assets	1,889	2,076
Total assets	$ 4,420,067	$4,388,068
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities:		
Accounts payable	$ 112,002	$81,636
Accrued payroll and benefits	32,434	28,005
Accrued interest payable	42,059	41,426
Accrued taxes other than income	33,089	30,352
Environmental liabilities	14,442	11,065
Deferred revenue	46,371	54,186
Accrued product purchases	72,049	49,164
Energy commodity derivatives contracts, net	7,338	—
Current portion of long-term debt	—	249,938
Other current liabilities	32,836	33,589
Total current liabilities	392,620	579,361
Long-term debt	2,393,408	2,140,083
Long-term pension and benefits	68,134	71,227
Other noncurrent liabilities	16,382	17,734
Environmental liabilities	33,821	24,348

Commitments and contingencies		
Partners’ capital:		
Limited partner unitholders (226,201 units and 226,679 units outstanding at December 31, 2012 and June 30, 2013, respectively)	1,550,760	1,589,625
Accumulated other comprehensive loss	(35,058)	(34,310)
Total partners’ capital	1,515,702	1,555,315
Total liabilities and partners' capital	$ 4,420,067	$4,388,068

See notes to consolidated financial statements.

Table of Contents

MAGELLAN MIDSTREAM PARTNERS, L.P.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, in thousands)

	Six Months Ended June 30, 2012	2013
Operating Activities:		
Net income	$231,345	$266,607
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	62,996	70,518
Debt placement fee amortization	1,037	1,080
Loss on sale, retirement and impairment of assets	7,359	2,298
Earnings of non-controlled entities	(3,126)	(2,787)
Distributions from investments in non-controlled entities	3,126	1,302
Equity-based incentive compensation expense	7,008	10,282
Changes in employee benefit plan assets and benefit obligations	1,705	982
Changes in operating assets and liabilities:		
Trade accounts receivable and other accounts receivable	(1,025)	8,167
Inventory	43,193	13,984
Energy commodity derivatives contracts, net of derivatives deposits	25,665	(4,628)
Reimbursable costs	849	3,162
Accounts payable	(9,882)	(322)
Accrued payroll and benefits	(8,488)	(4,429)
Accrued interest payable	—	(633)
Accrued taxes other than income	(2,714)	(2,737)
Accrued product purchases	(4,658)	(22,885)
Deferred revenue	1,052	7,815
Current and noncurrent environmental liabilities	(6,066)	(12,850)
Other current and noncurrent assets and liabilities	(10,890)	7,081
Net cash provided by operating activities	338,486	342,007
Investing Activities:		
Property, plant and equipment:		
Additions to property, plant and equipment	(108,098)	(181,165)
Proceeds from sale and disposition of assets	237	2,305
Increase (decrease) in accounts payable related to capital expenditures	9,533	(30,044)
Investments in non-controlled entities	(15,872)	(99,667)
Distributions in excess of earnings of non-controlled entities	1,227	750
Net cash used by investing activities	(112,973)	(307,821)
Financing Activities:		
Distributions paid	(187,181)	(228,380)
Decrease in outstanding checks	(1,235)	(2,334)
Settlement of tax withholdings on long-term incentive compensation	(13,001)	(12,259)
Net cash used by financing activities	(201,417)	(242,973)
Change in cash and cash equivalents	24,096	(208,787)
Cash and cash equivalents at beginning of period	209,620	328,278
Cash and cash equivalents at end of period	$233,716	$119,491
Supplemental non-cash financing activity:		

Issuance of limited partner units in settlement of equity-based incentive plan awards	$7,295	$6,404

See notes to consolidated financial statements.

Table of Contents

MAGELLAN MIDSTREAM PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization, Description of Business and Basis of Presentation

Organization

Unless indicated otherwise, the terms "our," "we," "us" and similar language refer to Magellan Midstream Partners, L.P. together with its subsidiaries. We are a Delaware limited partnership and our limited partner units are traded on the New York Stock Exchange under the ticker symbol "MMP." Magellan GP, LLC, a wholly-owned Delaware limited liability company, serves as our general partner.

During first quarter 2013, we completed a reorganization of our reporting segments. This reorganization was effected to reflect strategic changes in our businesses, particularly in the area of our crude oil activities, which have had or will have a significant impact on the way we manage our operations. Accordingly, we have updated our segment disclosures for all previous periods included in this report. Our reportable segments offer different products and services and are managed separately because each requires different marketing strategies and business knowledge.

Description of Business

We are principally engaged in the transportation, storage and distribution of refined petroleum products and crude oil. As of June 30, 2013, our asset portfolio consisted of:

- our refined products segment, including our 8,800-mile refined products pipeline system with 49 terminals as well as 27 independent terminals not connected to our pipeline system and our 1,100-mile ammonia pipeline system;
- our crude oil segment, comprised of approximately 800 miles of crude oil pipelines and storage facilities with an aggregate storage capacity of approximately 15 million barrels; and
- our marine storage segment, consisting of marine terminals located along coastal waterways with an aggregate storage capacity of more than 26 million barrels.

Products transported, stored and distributed through our pipelines and terminals include:

- refined products, which are the output from refineries and are primarily used as fuels by consumers. Refined products include gasoline, diesel fuel, aviation fuel, kerosene and heating oil. Collectively, diesel fuel and heating oil are referred to as distillates;
- liquefied petroleum gases, or LPGs, which are produced as by-products of the crude oil refining process and in connection with natural gas production. LPGs include butane and propane;
- blendstocks, which are blended with refined products to change or enhance their characteristics such as increasing a gasoline's octane or oxygen content. Blendstocks include alkylates and oxygenates;
- heavy oils and feedstocks, which are used as burner fuels or feedstocks for further processing by refineries and petrochemical facilities. Heavy oils and feedstocks include No. 6 fuel oil and vacuum gas oil;
- crude oil and condensate, which are used as feedstocks by refineries and petrochemical facilities;
- biofuels, such as ethanol and biodiesel, which are increasingly required by government mandates; and
- ammonia, which is primarily used as a nitrogen fertilizer.

Except for ammonia, we use the term petroleum products to describe any, or a combination, of the above-noted products.

Basis of Presentation

In the opinion of management, our accompanying consolidated financial statements which are unaudited, except for the consolidated balance sheet as of December 31, 2012, which is derived from our audited financial statements, include all normal and recurring adjustments necessary to present fairly our financial position as of June 30, 2013, the results of operations for the three and six months ended June 30, 2012 and 2013 and cash flows for the six months ended June 30, 2012 and 2013. The

Table of Contents

results of operations for the six months ended June 30, 2013 are not necessarily indicative of the results to be expected for the full year ending December 31, 2013.

Pursuant to the rules and regulations of the Securities and Exchange Commission, the financial statements in this report do not include all of the information and notes normally included with financial statements prepared in accordance with accounting principles generally accepted in the United States. These 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, 2012 and the updates to our Annual Report reflecting changes in our reporting segments included in our Current Report on Form 8-K filed with the Securities and Exchange Commission on April 29, 2013.

2. Product Sales Revenue

The amounts reported as product sales revenue on our consolidated statements of income include revenue from the physical sale of petroleum products and from mark-to-market adjustments from New York Mercantile Exchange ("NYMEX") contracts. We use NYMEX contracts to hedge against changes in the price of refined products we expect to sell from our business activities where we acquire or produce petroleum products. Some of these NYMEX contracts qualify for hedge accounting treatment and we designate and account for these as either cash flow or fair value hedges. The effective portion of the fair value changes in contracts designated as cash flow hedges are recognized as adjustments to product sales when the hedged product is physically sold. Ineffectiveness in the contracts designated as cash flow hedges is recognized as an adjustment to product sales in the period the ineffectiveness occurs. We account for NYMEX contracts that do not qualify for hedge accounting treatment as economic hedges, with the period changes in fair value recognized as product sales, except for those agreements that economically hedge the inventories associated with our pipeline system overages (the period changes in the fair value of these agreements are charged to operating expense). See Note 8 - Derivative Financial Instruments for further disclosures regarding our NYMEX contracts.

For the three and six months ended June 30, 2012 and 2013, product sales revenue included the following (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2013	2012	2013
Physical sale of petroleum products	$163,418	$145,580	$471,124	$353,460
NYMEX contract adjustments:				
Change in value of NYMEX contracts that did not qualify for hedge accounting treatment and the effective portion of gains and losses of matured NYMEX contracts that qualified for hedge accounting treatment associated with our butane blending and fractionation activities(1)	27,850	12,342	2,961	6,184
Change in value of NYMEX contracts that did not qualify for hedge accounting treatment associated with the Houston-to-El Paso pipeline linefill working inventory(1)	9,020	—	1,921	—
Other	280	—	292	(11)
Total NYMEX contract adjustments	37,150	12,342	5,174	6,173
Total product sales revenue	$200,568	$157,922	$476,298	$359,633

(1) The associated petroleum products for these activities are, to the extent still owned as of the statement date, or were, to the extent no longer owned as of the statement date, classified as inventory in current assets on our consolidated balance sheets.

3. Segment Disclosures

During the first quarter of 2013, we revised our reporting segments. See Note 1—Organization, Description of Business and Basis of Presentation for a discussion of this matter.

Our reportable segments are strategic business units that offer different products and services. Our segments are managed separately because each segment requires different marketing strategies and business knowledge. Management evaluates performance based on segment operating margin, which includes revenue from affiliates and external customers, operating

Table of Contents
MAGELLAN MIDSTREAM PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expenses, product purchases and earnings of non-controlled entities. Transactions between our business segments are conducted and recorded on the same basis as transactions with third-party entities.

We believe that investors benefit from having access to the same financial measures used by management. Operating margin, which is presented in the following tables, is an important measure used by management to evaluate the economic performance of our core operations. Operating margin is not a generally accepted accounting principles ("GAAP") measure, but the components of operating margin are computed using amounts that are determined in accordance with GAAP. A reconciliation of operating margin to operating profit, which is its nearest comparable GAAP financial measure, is included in the tables below. Operating profit includes depreciation and amortization expense and general and administrative ("G&A") expenses that management does not focus on when evaluating the core profitability of our separate operating segments.

	Three Months Ended June 30, 2012 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$187,262	$22,545	$38,954	$—	$248,761
Product sales revenue	199,840	—	728	—	200,568
Affiliate management fee revenue	—	198	—	—	198
Total revenue	387,102	22,743	39,682	—	449,527
Operating expenses	66,153	1,502	15,341	(670)	82,326
Product purchases	143,962	—	536	—	144,498
(Earnings) losses of non-controlled entities	—	(1,493)	15	—	(1,478)
Operating margin	176,987	22,734	23,790	670	224,181
Depreciation and amortization expense	21,586	2,594	6,636	670	31,486
G&A expenses	20,273	1,270	3,871	—	25,414
Operating profit	$135,128	$18,870	$13,283	$—	$167,281

	Three Months Ended June 30, 2013 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$202,397	$41,158	$38,907	$—	$282,462
Product sales revenue	156,321	—	1,601	—	157,922
Affiliate management fee revenue	—	3,239	289	—	3,528
Total revenue	358,718	44,397	40,797	—	443,912
Operating expenses	66,456	4,027	7,694	(762)	77,415
Product purchases	114,460	—	868	—	115,328
Earnings of non-controlled entities	—	(110)	(626)	—	(736)
Operating margin	177,802	40,480	32,861	762	251,905
Depreciation and amortization expense	21,224	5,104	7,096	762	34,186
G&A expenses	23,292	4,915	5,055	—	33,262
Operating profit	$133,286	$30,461	$20,710	$—	$184,457

Table of Contents
MAGELLAN MIDSTREAM PARTNERS, L.P.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six Months Ended June 30, 2012 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$344,932	$43,758	$77,625	$—	$466,315
Product sales revenue	472,658	—	3,640	—	476,298
Affiliate management fee revenue	—	397	—	—	397
Total revenue	817,590	44,155	81,265	—	943,010
Operating expenses	123,359	605	28,218	(1,404)	150,778
Product purchases	391,798	—	1,312	—	393,110
(Earnings) losses of non-controlled entities	—	(3,161)	35	—	(3,126)
Operating margin	302,433	46,711	51,700	1,404	402,248
Depreciation and amortization expense	42,643	5,756	13,193	1,404	62,996
G&A expenses	39,310	2,391	7,457	—	49,158
Operating profit	$220,480	$38,564	$31,050	$—	$290,094

	Six Months Ended June 30, 2013 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$367,756	$64,386	$77,591	$—	$509,733
Product sales revenue	355,736	—	3,897	—	359,633
Affiliate management fee revenue	—	6,398	569	—	6,967
Total revenue	723,492	70,784	82,057	—	876,333
Operating expenses	112,737	9,134	22,247	(1,522)	142,596
Product purchases	272,758	—	2,968	—	275,726
Earnings of non-controlled entities	—	(1,485)	(1,302)	—	(2,787)
Operating margin	337,997	63,135	58,144	1,522	460,798
Depreciation and amortization expense	42,577	12,573	13,846	1,522	70,518
G&A expenses	44,494	9,042	9,782	—	63,318
Operating profit	$250,926	$41,520	$34,516	$—	$326,962

4. Investments in Non-Controlled Entities

We own a 50% interest in Texas Frontera, LLC ("Texas Frontera"), which owns 0.8 million barrels of refined products storage at our Galena Park, Texas terminal. The storage capacity owned by this venture is leased to an affiliate of Texas Frontera under a long-term lease agreement. Texas Frontera began operations in October 2012. We receive management fees from Texas Frontera, which we report as affiliate management fee revenue on our consolidated statements of income.

We own a 50% interest in Osage Pipe Line Company, LLC ("Osage"), which owns a 135-mile crude oil pipeline that we operate. We receive management fees from Osage, which we report as affiliate management fee revenue on our consolidated statements of income.

We own a 50% interest in Double Eagle Pipeline LLC ("Double Eagle"), which owns a 140-mile pipeline that connects to an existing pipeline owned by an affiliate of Double Eagle. Double Eagle is operated by a third-party entity. This pipeline, which began limited operation in second quarter 2013, transports condensate from the Eagle Ford shale formation to our terminal in Corpus Christi, Texas.

We own a 50% interest in BridgeTex Pipeline Company, LLC ("BridgeTex"), which is in the process of constructing a 450-mile pipeline with related infrastructure to transport crude oil from Colorado City, Texas for delivery to Houston and Texas City, Texas refineries. This pipeline is expected to begin service in mid-2014. We receive construction management fees from BridgeTex, which we report as affiliate management fee revenue on our consolidated statements of income.

A summary of our investments in non-controlled entities follows (in thousands):

	Texas Frontera	Osage	Double Eagle	BridgeTex	Consolidated
Investment at December 31, 2012					