MAGELLAN MIDSTREAM PARTNERS LP
Form 10-Q
November 02, 2016

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 September 30, 2016

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 November 1, 2016, there were 227,783,916 outstanding limited partner units of Magellan Midstream Partners, L.P. that trade on the New York Stock Exchange under the ticker symbol "MMP."

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FINANCIAL INFORMATION

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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 September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Transportation and terminals revenue	$410,387	$413,433	$1,149,100	$1,175,748
Product sales revenue	172,731	133,356	455,827	403,607
Affiliate management fee revenue	3,557	4,993	10,478	11,140
Total revenue	586,675	551,782	1,615,405	1,590,495
Costs and expenses:				
Operating	147,349	135,286	396,374	392,681
Cost of product sales	85,522	118,242	316,208	327,530
Depreciation and amortization	42,043	47,081	124,180	134,137
General and administrative	37,612	35,800	111,052	111,216
Total costs and expenses	312,526	336,409	947,814	965,564
Earnings of non-controlled entities	15,521	18,576	49,653	51,543
Operating profit	289,670	233,949	717,244	676,474
Interest expense	40,419	50,163	118,009	142,573
Interest income	(310)	(302)	(993)	(1,067)
Interest capitalized	(3,984)	(7,877)	(9,037)	(21,143)
Gain on exchange of interest in non-controlled entity	—	—	—	(28,144)
Other expense (income)	1,706	(3,324)	(4,554)	(7,519)
Income before provision for income taxes	251,839	195,289	613,819	591,774
Provision for income taxes	867	738	1,820	2,294
Net income	$250,972	$194,551	$611,999	$589,480
Basic net income per limited partner unit	$1.10	$0.85	$2.69	$2.59
Diluted net income per limited partner unit	$1.10	$0.85	$2.69	$2.59
Weighted average number of limited partner units outstanding used for basic net income per unit calculation(1)	227,580	227,960	227,540	227,913
Weighted average number of limited partner units outstanding used for diluted net income per unit calculation(1)	227,945	227,999	227,702	227,947

(1) See Note 10–Long-Term Incentive Plan for additional information regarding our weighted average unit calculations.

See notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Net income	$250,972	$194,551	$611,999	$589,480
Other comprehensive income:				
Derivative activity:				
Net loss on cash flow hedges(1)	(3,410)	(3,169)	(16,939)	(24,278)
Reclassification of net loss on cash flow hedges to income(1)	388	512	976	1,288
Changes in employee benefit plan assets and benefit obligations recognized in other comprehensive income:				
Amortization of prior service credit(2)	(928)	(973)	(2,784)	(2,920)
Amortization of actuarial loss(2)	1,798	1,452	5,393	4,145
Settlement cost(2)	—	202	—	202
Total other comprehensive loss	(2,152)	(1,976)	(13,354)	(21,563)
Comprehensive income	$248,820	$192,575	$598,645	$567,917

(1) See Note 8–Derivative Financial Instruments for details of the amount of gain/loss recognized in accumulated other comprehensive loss (“AOCL”) for derivative financial instruments and the amount of gain/loss reclassified from AOCL into income.
(2) See Note 6–Employee Benefit Plans for details of the changes in employee benefit plan assets and benefit obligations recognized in AOCL.

See notes to consolidated financial statements.

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

	December 31, 2015	September 30, 2016 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 28,731	$ 291,097
Trade accounts receivable	83,893	126,141
Other accounts receivable	12,701	24,867
Inventory	130,868	123,011
Energy commodity derivatives contracts, net	39,243	—
Energy commodity derivatives deposits	—	30,559
Other current assets	43,418	52,600
Total current assets	338,854	648,275
Property, plant and equipment	6,166,766	6,657,305
Less: Accumulated depreciation	1,347,537	1,471,263
Net property, plant and equipment	4,819,229	5,186,042
Investments in non-controlled entities	765,628	912,419
Long-term receivables	20,374	22,101
Goodwill	53,260	53,260
Other intangibles (less accumulated amortization of $13,709 and $2,010 at December 31, 2015 and September 30, 2016, respectively)	1,856	52,102
Tank bottoms	27,533	35,429
Other noncurrent assets	14,833	10,157
Total assets	$ 6,041,567	$ 6,919,785
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities:		
Accounts payable	$ 104,094	$ 101,012
Accrued payroll and benefits	51,764	39,039
Accrued interest payable	51,296	48,903
Accrued taxes other than income	51,587	53,702
Environmental liabilities	15,679	11,711
Deferred revenue	81,627	98,818
Accrued product purchases	31,339	25,156
Energy commodity derivatives contracts, net	—	12,430
Energy commodity derivatives deposits	24,252	—
Current portion of long-term debt, net	250,335	250,020
Other current liabilities	51,099	43,058
Total current liabilities	713,072	683,849
Long-term debt, net	3,189,287	4,073,502
Long-term pension and benefits	77,551	70,416
Other noncurrent liabilities	24,162	29,408
Environmental liabilities	15,759	14,078
Commitments and contingencies		
Partners' capital:		

Limited partner unitholders (227,427 units and 227,784 units outstanding at December 31, 2015 and September 30, 2016, respectively)	2,118,086	2,166,445
Accumulated other comprehensive loss	(96,350)	(117,913)
Total partners' capital	2,021,736	2,048,532
Total liabilities and partners' capital	$ 6,041,567	$ 6,919,785

See notes to consolidated financial statements.

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

	Nine Months Ended September 30,	
	2015	2016
Operating Activities:		
Net income	$611,999	$589,480
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	124,180	134,137
Loss on sale and retirement of assets	4,378	5,397
Earnings of non-controlled entities	(49,653)	(51,543)
Distributions of earnings from investments in non-controlled entities	47,236	50,047
Equity-based incentive compensation expense	15,226	14,737
Settlement cost, amortization of prior service credit and actuarial loss	2,609	1,427
Gain on exchange of interest in non-controlled entity	—	(28,144)
Changes in operating assets and liabilities:		
Trade accounts receivable and other accounts receivable	(24,601)	(49,014)
Inventory	22,581	7,857
Energy commodity derivatives contracts, net of derivatives deposits	(11,402)	637
Accounts payable	12,226	5,850
Accrued payroll and benefits	452	(12,725)
Accrued interest payable	(841)	(2,393)
Accrued taxes other than income	6,334	2,115
Accrued product purchases	(23,947)	(6,183)
Deferred revenue	4,141	17,191
Current and noncurrent environmental liabilities	(4,864)	(5,649)
Other current and noncurrent assets and liabilities	(11,950)	(34,229)
Net cash provided by operating activities	724,104	638,995
Investing Activities:		
Additions to property, plant and equipment, net[1]	(431,260)	(517,810)
Proceeds from sale and disposition of assets	3,178	6,098
Acquisition of business	(54,678)	—
Investments in non-controlled entities	(133,373)	(174,900)
Distributions in excess of earnings of non-controlled entities	9,341	4,500
Net cash used by investing activities	(606,792)	(682,112)
Financing Activities:		
Distributions paid	(489,535)	(548,388)
Net commercial paper repayments	(69,976)	(244,963)
Borrowings under long-term notes	499,589	1,142,997
Debt placement costs	(4,754)	(10,500)
Net payment on financial derivatives	(42,908)	(19,287)
Settlement of tax withholdings on long-term incentive compensation	(17,784)	(14,376)
Net cash provided (used) by financing activities	(125,368)	305,483
Change in cash and cash equivalents	(8,056)	262,366
Cash and cash equivalents at beginning of period	17,063	28,731
Cash and cash equivalents at end of period	$9,007	$291,097

Supplemental non-cash investing and financing activities:		
Contribution of property, plant and equipment to a non-controlled entity	$13,252	$—
Issuance of limited partner units in settlement of equity-based incentive plan awards	$8,045	$7,092

(1) Additions to property, plant and equipment	$(439,721)	$(514,205)
Changes in accounts payable and other current liabilities related to capital expenditures	8,461	(3,605)
Additions to property, plant and equipment, net	$(431,260)	$(517,810)

See notes to consolidated financial statements.

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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.

Description of Business

We are principally engaged in the transportation, storage and distribution of refined petroleum products and crude oil. As of September 30, 2016, our asset portfolio, including the assets of our joint ventures, consisted of:

- our refined products segment, comprised of our 9,700-mile refined products pipeline system with 53 terminals as well as 26 independent terminals not connected to our pipeline system and our 1,100-mile ammonia pipeline system;

- our crude oil segment, comprised of approximately 2,100 miles of crude oil pipelines and storage facilities with an aggregate storage capacity of approximately 23 million barrels, of which approximately 15 million barrels are used for leased storage; and

- our marine storage segment, consisting of five marine terminals located along coastal waterways with an aggregate storage capacity of approximately 26 million barrels.

Terminology common in our industry includes the following terms, which describe products that we transport, store and distribute through our pipelines and terminals:

- refined products 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, are produced as by-products of the crude oil refining process and in connection with natural gas production. LPGs include butane and propane;

- blendstocks are blended with refined products to change or enhance their characteristics such as increasing a gasoline’s octane or oxygen content. Blendstocks include alkylates, oxygenates and natural gasoline;

- heavy oils and feedstocks 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 are used as feedstocks by refineries and petrochemical facilities;

- biofuels, such as ethanol and biodiesel, are increasingly required by government mandates; and

- ammonia 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.

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

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, 2015, which is derived from our audited financial statements, include all normal and recurring adjustments necessary to present fairly our financial position as of September 30, 2016, the results of operations for the three and nine months ended September 30, 2015 and 2016 and cash flows for the nine months ended September 30, 2015 and 2016. The results of operations for the nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full year ending December 31, 2016 for several reasons. Profits from our butane blending activities are realized largely during the first and fourth quarters of each year. Additionally, gasoline demand, which drives transportation volumes and revenues on our pipeline systems, generally trends higher during the summer driving months. Further, the volatility of commodity prices impacts the profits from our commodity activities and, to a lesser extent, the volume of petroleum products we transport on our pipelines.

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 U.S. generally accepted accounting principles (“GAAP”). 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, 2015.

Use of Estimates

The preparation of our consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities that exist at the date of our consolidated financial statements, as well as their impact on the reported amounts of revenue and expense during the reporting periods. Actual results could differ from those estimates.

New Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, which is part of the FASB’s initiative to simplify accounting standards. The guidance requires an entity to make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest or account for forfeitures when they occur, and allows equity classification for awards where employees elect to withhold up to the maximum statutory tax rates in the applicable jurisdictions. The new standard also requires cash paid by employers when directly withholding shares for tax withholding purposes to be classified as a financing activity in the statement of cash flows.

We elected to early adopt ASU 2016-09 during the first quarter of 2016, and this adoption did not have a material impact on our consolidated financial statements. In conjunction with our adoption of this new accounting standard, we have elected to account for equity-based compensation forfeitures as they occur. Additionally, and consistent with our prior accounting policy, we continue to show cash paid when directly withholding shares for tax withholding purposes as a financing activity in our statements of cash flows.

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). This ASU requires lessees to recognize a right of use asset and lease liability on the balance sheet for all leases, with the exception of short-term leases. The new accounting model for lessors remains largely the same, although some changes have been made to align it with the new lessee model and the new revenue recognition guidance. This update also requires companies to include additional disclosures regarding their lessee and lessor agreements. Public companies are required to adopt the

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

standard for financial reporting periods that start after December 15, 2018, although early adoption is permitted. We are currently in the process of evaluating the impact this new standard will have on our financial statements.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, which eliminates the industry-specific guidance in U.S. GAAP and produces a single, principles-based method for companies to report revenue in their financial statements. This standard requires companies to make more estimates and use more judgment than under current guidance. In addition, all companies must compile more extensive footnote disclosures about how the revenue numbers were derived. This ASU requires full retrospective, modified retrospective or use of the cumulative effect method during the period of adoption. In July 2015, the FASB extended the effective date of this standard from January 1, 2017 to January 1, 2018. We are currently in the process of evaluating the impact this new standard will have on our financial statements.

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 mark-to-market adjustments from New York Mercantile Exchange ("NYMEX") contracts. See Note 8 – Derivative Financial Instruments for a discussion of our commodity hedging strategies and how our NYMEX contracts impact product sales revenue. All of the petroleum products inventory we physically sell associated with our butane blending and fractionation activities, as well as the barrels from product gains we obtain from our operations, are reported as product sales revenue on our consolidated statements of income.
For the three and nine months ended September 30, 2015 and 2016, product sales revenue included the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2016	2015	2016
Physical sale of petroleum products	$100,829	$146,006	$403,395	$412,045
Change in value of NYMEX contracts	71,902	(12,650)	52,432	(8,438)
Total product sales revenue	$172,731	$133,356	$455,827	$403,607

3. Segment Disclosures

Our reportable segments are strategic business units that offer different products and services. Our segments are managed separately as 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 expenses, cost of product sales and earnings of non-controlled 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 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") expense that management does not consider when evaluating the core profitability of our separate operating segments.

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

	Three Months Ended September 30, 2015 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$264,156	$101,122	$45,109	$ —	$410,387
Product sales revenue	171,775	—	956	—	172,731
Affiliate management fee revenue	—	3,211	346	—	3,557
Total revenue	435,931	104,333	46,411	—	586,675
Operating expenses	108,972	24,572	14,700	(895)	147,349
Cost of product sales	85,341	—	181	—	85,522
Losses (earnings) of non-controlled entities	48	(14,906)	(663)	—	(15,521)
Operating margin	241,570	94,667	32,193	895	369,325
Depreciation and amortization expense	24,333	9,502	7,313	895	42,043
G&A expenses	22,238	9,818	5,556	—	37,612
Operating profit	$194,999	$75,347	$19,324	$ —	$289,670

	Three Months Ended September 30, 2016 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$267,339	$100,113	$46,182	$ (201)	$413,433
Product sales revenue	105,834	24,750	2,772	—	133,356
Affiliate management fee revenue	218	4,416	359	—	4,993
Total revenue	373,391	129,279	49,313	(201)	551,782
Operating expenses	95,776	24,628	16,374	(1,492)	135,286
Cost of product sales	93,761	24,108	373	—	118,242
Losses (earnings) of non-controlled entities	272	(18,180)	(668)	—	(18,576)
Operating margin	183,582	98,723	33,234	1,291	316,830
Depreciation and amortization expense	28,432	9,333	8,025	1,291	47,081
G&A expenses	22,993	8,493	4,314	—	35,800
Operating profit	$132,157	$80,897	$20,895	$ —	$233,949

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

	Nine Months Ended September 30, 2015 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$723,156	$294,023	$131,921	$ —	$1,149,100
Product sales revenue	453,737	—	2,090	—	455,827
Affiliate management fee revenue	—	9,449	1,029	—	10,478
Total revenue	1,176,893	303,472	135,040	—	1,615,405
Operating expenses	288,265	65,032	45,916	(2,839)	396,374
Cost of product sales	315,301	—	907	—	316,208
Losses (earnings) of non-controlled entities	146	(47,735)	(2,064)	—	(49,653)
Operating margin	573,181	286,175	90,281	2,839	952,476
Depreciation and amortization expense	71,742	25,995	23,604	2,839	124,180
G&A expenses	68,730	26,935	15,387	—	111,052
Operating profit	$432,709	$233,245	$51,290	$ —	$717,244

	Nine Months Ended September 30, 2016 (in thousands)				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$739,931	$303,181	$132,837	$ (201)	$1,175,748
Product sales revenue	372,061	26,465	5,081	—	403,607
Affiliate management fee revenue	422	9,686	1,032	—	11,140
Total revenue	1,112,414	339,332	138,950	(201)	1,590,495
Operating expenses	280,261	66,370	49,897	(3,847)	392,681
Cost of product sales	300,009	26,469	1,052	—	327,530
Losses (earnings) of non-controlled entities	352	(49,870)	(2,025)	—	(51,543)
Operating margin	531,792	296,363	90,026	3,646	921,827
Depreciation and amortization expense	78,523	28,264	23,704	3,646	134,137
G&A expenses	68,852	27,419	14,945	—	111,216
Operating profit	$384,417	$240,680	$51,377	$ —	$676,474