

MAGELLAN MIDSTREAM PARTNERS LP  
Form 10-Q  
November 06, 2006  
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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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x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

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

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**Magellan Midstream 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)

One Williams Center, P.O. Box 22186, Tulsa, Oklahoma 74121-2186

(Address of principal executive offices and zip code)

73-1599053  
(IRS Employer

Identification No.)

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(918) 574-7000

(Registrant's telephone number, including area code)

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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 is a large accelerated filer, an accelerated filer or a non-accelerated filer.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company. Yes  No

As of November 6, 2006, there were outstanding 66,360,624 common units.

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**Table of Contents****PART I****FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MAGELLAN MIDSTREAM PARTNERS, L.P.****CONSOLIDATED STATEMENTS OF INCOME****(In thousands, except per unit amounts)****(Unaudited)**

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
Transportation and terminals revenues	\$ 131,647	\$ 144,702	\$ 370,272	\$ 413,448
Product sales revenues	182,129	171,762	457,089	493,464
Affiliate management fee revenue	167	173	501	518
<b>Total revenues</b>	<b>313,943</b>	<b>316,637</b>	<b>827,862</b>	<b>907,430</b>
<b>Costs and expenses:</b>				
Operating	63,379	62,529	159,434	168,220
Environmental	6,942	8,522	9,914	11,261
Product purchases	160,500	169,741	414,159	458,193
Depreciation and amortization	14,498	15,182	41,399	45,739
Affiliate general and administrative	15,784	17,042	46,044	47,806
<b>Total costs and expenses</b>	<b>261,103</b>	<b>273,016</b>	<b>670,950</b>	<b>731,219</b>
Equity earnings	909	814	2,231	2,479
<b>Operating profit</b>	<b>53,749</b>	<b>44,435</b>	<b>159,143</b>	<b>178,690</b>
Interest expense	13,846	14,359	39,508	43,116
Interest income	(1,287)	(482)	(3,429)	(1,729)
Interest capitalized	(299)	(714)	(679)	(1,346)
Debt placement fee amortization	731	679	2,194	2,034
Other (income) expense			(300)	339
<b>Net income</b>	<b>\$ 40,758</b>	<b>\$ 30,593</b>	<b>\$ 121,849</b>	<b>\$ 136,276</b>
Allocation of net income for purposes of calculating earnings per limited partner unit:				
Limited partners' interest	\$ 37,143	\$ 28,335	\$ 105,157	\$ 106,163
General partner's interest	3,615	2,258	16,692	30,113
<b>Net income</b>	<b>\$ 40,758</b>	<b>\$ 30,593</b>	<b>\$ 121,849</b>	<b>\$ 136,276</b>
<b>Basic net income per limited partner unit</b>	<b>\$ 0.56</b>	<b>\$ 0.43</b>	<b>\$ 1.58</b>	<b>\$ 1.60</b>
Weighted average number of limited partner units outstanding used for basic net income per unit calculation	66,361	66,361	66,361	66,361

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Diluted net income per limited partner unit	\$ 0.56	\$ 0.43	\$ 1.58	\$ 1.60
Weighted average number of limited partner units outstanding used for diluted net income per unit calculation	66,592	66,644	66,610	66,537

See notes to consolidated financial statements.

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**Table of Contents****MAGELLAN MIDSTREAM PARTNERS, L.P.****CONSOLIDATED BALANCE SHEETS****(In thousands)**

	<b>December 31, 2005</b>	<b>September 30, 2006 (Unaudited)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 36,489	\$ 73
Restricted cash	5,537	11,170
Accounts receivable (less allowance for doubtful accounts of \$133 and \$51 at December 31, 2005 and September 30, 2006, respectively)	49,373	58,269
Other accounts receivable	5,566	10,299
Affiliate accounts receivable	5,535	5,209
Inventory	78,155	91,965
Other current assets	5,034	8,317
<b>Total current assets</b>	<b>185,689</b>	<b>185,302</b>
Property, plant and equipment	2,116,143	2,207,761
Less: accumulated depreciation	506,626	545,043
<b>Net property, plant and equipment</b>	<b>1,609,517</b>	<b>1,662,718</b>
Equity investment	24,888	24,292
Long-term accounts receivable	7,327	7,026
Long-term affiliate accounts receivable	1,245	
Goodwill	24,430	24,033
Other intangibles (less accumulated amortization of \$3,607 and \$4,804 at December 31, 2005 and September 30, 2006, respectively)	11,652	10,455
Debt placement costs (less accumulated amortization of \$6,911 and \$8,945 at December 31, 2005 and September 30, 2006, respectively)	8,084	6,477
Other noncurrent assets	3,686	3,532
<b>Total assets</b>	<b>\$ 1,876,518</b>	<b>\$ 1,923,835</b>
<b>LIABILITIES AND PARTNERS CAPITAL</b>		
Current liabilities:		
Accounts payable	\$ 25,508	\$ 28,316
Affiliate accounts payable	5,821	10,111
Affiliate payroll and benefits	17,028	9,683
Accrued interest payable	9,628	22,639
Accrued taxes other than income	17,307	19,132
Environmental liabilities	30,840	33,118
Deferred revenue	17,522	19,218
Accrued product purchases	34,772	21,766
Current portion of long-term debt	14,345	14,345
Other current liabilities	13,124	26,191
<b>Total current liabilities</b>	<b>185,895</b>	<b>204,519</b>
Long-term debt	782,639	802,233
Long-term affiliate payable	10,091	8,213
Long-term affiliate pension and benefits	9,766	11,415

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Other deferred liabilities	52,773	55,184
Environmental liabilities	27,364	26,224
Commitments and contingencies		
Partners' capital:		
Partners' capital	810,045	818,592
Accumulated other comprehensive loss	(2,055)	(2,545)
Total partners' capital	807,990	816,047
Total liabilities and partners' capital	\$ 1,876,518	\$ 1,923,835

See notes to consolidated financial statements.

**Table of Contents****MAGELLAN MIDSTREAM PARTNERS, L.P.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)****(Unaudited)**

	<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2006</b>
<b>Operating Activities:</b>		
Net income	\$ 121,849	\$ 136,276
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	41,399	45,739
Debt placement fee amortization	2,194	2,034
Loss on sale and retirement of assets	8,574	5,435
Equity earnings	(2,231)	(2,479)
Distributions from equity investments	2,150	3,075
Changes in components of operating assets and liabilities:		
Accounts receivable and other accounts receivable	(311)	(12,906)
Affiliate accounts receivable	(455)	326
Inventory	114	(13,810)
Accounts payable	2,132	2,808
Affiliate accounts payable	7,875	4,290
Accrued interest payable	13,248	13,011
Accrued taxes other than income	2,600	1,825
Affiliate payroll and benefits	(6,790)	(7,345)
Accrued product purchases	1,651	(13,006)
Current and noncurrent environmental liabilities	(1,062)	1,138
Other current and noncurrent assets and liabilities	3,840	(2,425)
<b>Net cash provided by operating activities</b>	<b>196,777</b>	<b>163,986</b>
<b>Investing Activities:</b>		
Purchases of marketable securities	(50,500)	
Sales of marketable securities	138,302	
Additions to property, plant and equipment	(62,723)	(105,597)
Proceeds from sale of assets	164	1,273
Acquisition of businesses	(55,263)	
Prepaid construction costs from related party		4,500
<b>Net cash used by investing activities</b>	<b>(30,020)</b>	<b>(99,824)</b>
<b>Financing Activities:</b>		
Distributions paid	(115,062)	(153,486)
Borrowings under revolver		225,600
Payments on revolver		(205,100)
Short-term borrowings		7,076
Debt placement costs		(427)
Capital contributions by affiliate	19,038	25,742
Other	48	17
<b>Net cash used by financing activities</b>	<b>(95,976)</b>	<b>(100,578)</b>



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Change in cash and cash equivalents	70,781	(36,416)
Cash and cash equivalents at beginning of period	29,833	36,489
Cash and cash equivalents at end of period	\$ 100,614	\$ 73

See notes to consolidated financial statements.

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**MAGELLAN MIDSTREAM PARTNERS, L.P.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Organization and Basis of Presentation**

Unless indicated otherwise, the terms *our*, *we*, *us* and similar language refer to Magellan Midstream Partners, L.P. together with our subsidiaries. We are a Delaware limited partnership. Magellan GP, LLC, a Delaware limited liability company, serves as our general partner and owns a 2% general partner interest in us. Magellan GP, LLC is a wholly-owned subsidiary of Magellan Midstream Holdings, L.P. ( *MGG* ), a publicly traded Delaware limited partnership. We and Magellan GP, LLC have contracted with Magellan Midstream Holdings GP, LLC ( *MGG GP* ), *MGG*'s general partner, to provide all general and administrative services ( *G&A* ) and operating functions required for our operations.

We operate and report in three business segments: the petroleum products pipeline system, the petroleum products terminals and the ammonia pipeline system. Our reportable segments offer different products and services and are managed separately because each requires different marketing strategies and business knowledge.

In the opinion of management, our accompanying consolidated financial statements, which are unaudited except for the consolidated balance sheet as of December 31, 2005, which is derived from audited financial statements, include all normal and recurring adjustments necessary to present fairly our financial position as of September 30, 2006, and the results of operations for the three and nine months ended September 30, 2005 and 2006 and cash flows for the nine months ended September 30, 2005 and 2006. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year ending December 31, 2006.

Pursuant to the rules and regulations of the Securities and Exchange Commission, the financial statements 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, 2005.

**Table of Contents****MAGELLAN MIDSTREAM PARTNERS, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. Allocation of Net Income**

The allocation of net income between our general partner and limited partners for purposes of calculating net income per limited partner unit, follows (in thousands):

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2005</b>	<b>2006</b>	<b>2005</b>	<b>2006</b>
Net income	\$ 40,758	\$ 30,593	\$ 121,849	\$ 136,276
Direct charges to the general partner:				
Reimbursable G&A costs	1,049	(31)	2,693	934
Previously indemnified environmental charges	6,055	8,323	6,692	8,381
<b>Total direct charges to general partner</b>	<b>7,104</b>	<b>8,292</b>	<b>9,385</b>	<b>9,315</b>
Income before direct charges to general partner	47,862	38,885	131,234	145,591
General partner's share of distributions <sup>(a)</sup>	22.40%	27.13%	19.87%	27.08%
General partner's allocated share of net income before direct charges	10,719	10,550	26,077	39,428
Direct charges to general partner	7,104	8,292	9,385	9,315
Net income allocated to general partner	\$ 3,615	\$ 2,258	\$ 16,692	\$ 30,113
Net income	\$ 40,758	\$ 30,593	\$ 121,849	\$ 136,276
Less: net income allocated to general partner	3,615	2,258	16,692	30,113
<b>Net income allocated to limited partners</b>	<b>\$ 37,143</b>	<b>\$ 28,335</b>	<b>\$ 105,157</b>	<b>\$ 106,163</b>

(a) Under the two class method of computing earnings per unit, as prescribed by Statement of Financial Accounting Standards No. 128, Earnings Per Share, when our distributions for any quarterly period are less than net income, we allocate earnings for that period based on a theoretical distribution model which assumes total distributions are equal to net income. For periods where distributions exceed net income, we allocate net income to the general and limited partners based on the proportion of their contractually-determined cash distributions declared and paid following the close of each quarter. Because second quarter 2006 distributions were less than our net income, we allocated net income based on a theoretical distribution of \$0.61178 per unit, resulting in our general partner being allocated 28.3% of net income for that period. As noted above, our general partner's 27.08% share of distributions for the nine months ended September 30, 2006 is derived from its share of actual first and third quarter 2006 distributions plus its share of theoretical distributions for second quarter 2006.

Reimbursable G&A costs represent G&A expenses charged against our income during each respective period for which we either have been or will be reimbursed by our general partner under the terms of the new omnibus agreement (see Note 6 Related Party Transactions). Consequently, these amounts have been charged directly against our general partner's allocation of net income. We record these reimbursements by our general partner as capital contributions. During 2004, we and our general partner entered into an agreement with a former affiliate to settle its indemnification obligations to us (see Note 12 Commitments and Contingencies). Following this settlement, the expenses associated with these previously indemnified costs have been charged directly to our general partner. We believe we will collect the full amount of the indemnification settlement and accordingly will continue to allocate amounts associated with previously indemnified costs to our general partner.



**Table of Contents****MAGELLAN MIDSTREAM PARTNERS, L.P.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. Comprehensive Income**

A reconciliation of net income to comprehensive income is provided in the table below (in thousands). For information on our derivative instruments, see Note 11 Derivative Financial Instruments.

	Three Months Ended		Nine Months Ended	
	September 30, 2005	September 30, 2006	September 30, 2005	September 30, 2006
Net income	\$ 40,758	\$ 30,593	\$ 121,849	\$ 136,276
Change in fair value of cash flow hedges		338		(648)
Amortization of net loss on cash flow hedges	53	53	158	158
Other comprehensive income (loss)	53	391	158	(490)
Comprehensive income	\$ 40,811	\$ 30,984	\$ 122,007	\$ 135,786

**4. Asset Impairment**

In June 2006, we recorded a \$3.0 million charge against the earnings of our petroleum products pipeline system segment associated with an impairment of our Menard, Illinois terminal, which we may close in 2007. The impairment charge is included in operating expenses on our consolidated statements of income and the tables included in our segment disclosures note below. An impairment review was initiated during our review of second quarter results, which included management's reassessment of the system integrity costs that we would be required to incur on this terminal and the various probabilities of continuing to operate or close the facility. The carrying value of the Menard, Illinois terminal prior to the impairment was \$3.6 million. The fair value of the terminal was determined using probability-weighted discounted cash flow techniques.

**5. Segment Disclosures**

Our reportable segments are strategic business units that offer different products and services. The segments are managed separately because each segment requires different marketing strategies and business knowledge.

The non-generally accepted accounting principles measure of operating margin (in the aggregate and by segment) is presented in the following tables. The components of operating margin are computed by using amounts that are determined in accordance with generally accepted accounting principles (GAAP). A reconciliation of operating margin to operating profit, which is its nearest comparable GAAP financial measure, is included in the tables below. Management believes that investors benefit from having access to the same financial measures management uses to evaluate performance. Operating margin is an important measure of the economic performance of our core operations. This measure forms the basis of our internal financial reporting and is used by management in deciding how to allocate capital resources between segments. Operating profit, alternatively, includes expense items, such as depreciation and amortization and affiliate G&A costs, that management does not consider when evaluating the core profitability of an operation.

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

	Three Months Ended September 30, 2005 (in thousands)				
	Petroleum Products Pipeline System	Petroleum Products Terminals	Ammonia Pipeline System	Intersegment Eliminations	Total
Transportation and terminals revenues	\$ 103,307	\$ 25,358	\$ 3,745	\$ (763)	\$ 131,647
Product sales revenues	180,165	2,514		(550)	182,129
Affiliate management fee revenue	167				167
Total revenues	283,639	27,872	3,745	(1,313)	313,943
Operating expenses	52,836	9,838	2,197	(1,492)	63,379
Environmental	4,420	1,620	902		6,942
Product purchases	160,362	816		(678)	160,500
Equity earnings	(909)				(909)
Operating margin	66,930	15,598	646	857	84,031
Depreciation and amortization	9,550	3,897	194	857	14,498
Affiliate G&A	11,586	3,673	525		15,784
Operating profit	\$ 45,794	\$ 8,028	\$ (73)	\$	\$ 53,749

	Three Months Ended September 30, 2006 (in thousands)				
	Petroleum Products Pipeline System	Petroleum Products Terminals	Ammonia Pipeline System	Intersegment Eliminations	Total
Transportation and terminals revenues	\$ 111,139	\$ 30,900	\$ 3,517	\$ (854)	\$ 144,702
Product sales revenues	166,452	5,310			171,762
Affiliate management fee revenue	173				173
Total revenues	277,764	36,210	3,517	(854)	316,637
Operating expenses	49,649	11,289	3,211	(1,620)	62,529
Environmental	7,574	(4)	952		8,522
Product purchases	167,275	2,595		(129)	169,741
Equity earnings	(814)				(814)
Operating margin	54,080	22,330	(646)	895	76,659
Depreciation and amortization	9,400	4,687	200	895	15,182
Affiliate G&A	12,161	4,325	556		17,042
Operating profit	\$ 32,519	\$ 13,318	\$ (1,402)	\$	\$ 44,435

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

	Nine Months Ended September 30, 2005 (in thousands)				
	Petroleum Products Pipeline System	Petroleum Products Terminals	Ammonia Pipeline System	Intersegment Eliminations	Total
Transportation and terminals revenues	\$ 286,406	\$ 76,374	\$ 9,952	\$ (2,460)	\$ 370,272
Product sales revenues	449,124	8,925		(960)	457,089
Affiliate management fee revenue	501				501
Total revenues	736,031	85,299	9,952	(3,420)	827,862
Operating expenses	129,710	28,659	5,611	(4,546)	159,434
Environmental	6,950	1,710	1,254		9,914
Product purchases	412,009	3,491		(1,341)	414,159
Equity earnings	(2,231)				(2,231)
Operating margin	189,593				