NuStar Energy L.P.
Form 10-Q
April 25, 2012

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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, 2012

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 March 31, 2012 was 70,756,078.

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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, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	$37,696	$17,497
Accounts receivable, net of allowance for doubtful accounts of $1,774 and $2,147 as of March 31, 2012 and December 31, 2011, respectively	495,982	547,808
Inventories	774,008	587,785
Income tax receivable	9,221	4,148
Other current assets	51,489	43,685
Total current assets	1,368,396	1,200,923
Property, plant and equipment, at cost	4,526,182	4,413,305
Accumulated depreciation and amortization	(1,026,553)	(982,837)
Property, plant and equipment, net	3,499,629	3,430,468
Intangible assets, net	36,900	38,923
Goodwill	849,040	846,717
Investment in joint venture	69,073	66,687
Deferred income tax asset	10,479	9,141
Other long-term assets, net	249,911	288,331
Total assets	$6,083,428	$5,881,190
Liabilities and Partners' Equity		
Current liabilities:		
Current portion of long-term debt	$831,374	$364,959
Accounts payable	528,376	454,326
Payable to related party	15,312	6,735
Accrued interest payable	24,283	29,833
Accrued liabilities	75,711	71,270
Taxes other than income tax	13,014	13,455
Income tax payable	4,620	3,222
Total current liabilities	1,492,690	943,800
Long-term debt, less current portion	1,690,038	1,928,071
Long-term payable to related party	13,672	14,502
Deferred income tax liability	36,670	35,437
Other long-term liabilities	86,140	95,045
Commitments and contingencies (Note 5)		
Partners' equity:		
Limited partners (70,756,078 common units outstanding as of March 31, 2012 and December 31, 2011)	2,755,526	2,817,069
General partner	61,088	62,539
Accumulated other comprehensive loss	(65,552)	(27,407)
Total NuStar Energy L.P. partners' equity	2,751,062	2,852,201

Noncontrolling interest	13,156	12,134
Total partners’ equity	2,764,218	2,864,335
Total liabilities and partners’ equity	$6,083,428	$5,881,190

See Condensed Notes to Consolidated Financial Statements.

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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 March 31, 2012	2011
Revenues:		
Service revenues:		
Third parties	$205,448	$198,263
Related party	697	130
Total service revenues	206,145	198,393
Product sales	1,529,547	1,036,223
Total revenues	1,735,692	1,234,616
Costs and expenses:		
Cost of product sales	1,489,837	992,367
Operating expenses:		
Third parties	86,734	85,130
Related party	38,932	35,109
Total operating expenses	125,666	120,239
General and administrative expenses:		
Third parties	8,018	9,035
Related party	19,169	16,948
Total general and administrative expenses	27,187	25,983
Depreciation and amortization expense	44,681	40,296
Total costs and expenses	1,687,371	1,178,885
Operating income	48,321	55,731
Equity in earnings of joint venture	2,386	2,388
Interest expense, net	(22,350)	(20,457)
Other income (expense), net	1,368	(5,499)
Income before income tax expense	29,725	32,163
Income tax expense	3,471	3,647
Net income	26,254	28,516
Less net (loss) income attributable to noncontrolling interest	(97)	14
Net income attributable to NuStar Energy L.P.	$26,351	$28,502
Net income per unit applicable to limited partners (Note 11)	$0.23	$0.30
Weighted-average limited partner units outstanding	70,756,078	64,610,549
Comprehensive (loss) income	$(10,772)	$40,499
Less comprehensive income attributable to noncontrolling interest	1,022	566
Comprehensive (loss) income attributable to NuStar Energy L.P.	$(11,794)	$39,933

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,	
	2012	2011
Cash Flows from Operating Activities:		
Net income	$26,254	$28,516
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization expense	44,681	40,296
Amortization of debt related items	(2,912)	(1,973)
Deferred income tax benefit	(1,042)	(551)
Equity in earnings of joint venture	(2,386)	(2,388)
Distributions of equity in earnings of joint venture	—	2,923
Changes in current assets and current liabilities (Note 12)	(76,458)	(232,899)
Other, net	2,250	278
Net cash used in operating activities	(9,613)	(165,798)
Cash Flows from Investing Activities:		
Reliability capital expenditures	(6,805)	(7,372)
Strategic capital expenditures	(93,479)	(65,874)
Acquisitions	—	(52,577)
Investment in other long-term assets	(94)	(636)
Other, net	164	58
Net cash used in investing activities	(100,214)	(126,401)
Cash Flows from Financing Activities:		
Proceeds from long-term debt borrowings	454,118	343,680
Proceeds from short-term debt borrowings	56,430	31,600
Proceeds from senior note offering, net of issuance costs	247,408	—
Long-term debt repayments	(453,944)	(82,394)
Short-term debt repayments	(56,430)	(31,600)
Distributions to unitholders and general partner	(89,076)	(79,616)
Payments for termination of interest rate swaps	(25,358)	—
Other, net	(3,228)	(1,144)
Net cash provided by financing activities	129,920	180,526
Effect of foreign exchange rate changes on cash	106	989
Net increase (decrease) in cash and cash equivalents	20,199	(110,684)
Cash and cash equivalents as of the beginning of the period	17,497	181,121
Cash and cash equivalents as of the end of the period	$37,696	$70,437

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. (NuStar Energy) (NYSE: NS) is engaged in the terminalling and storage of petroleum products, the transportation of petroleum products and anhydrous ammonia, and petroleum refining and 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 16.2% total interest in us as of March 31, 2012.
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 condensed consolidated financial statements include the accounts of the Partnership and subsidiaries in which the Partnership has a controlling interest. Noncontrolling interests are separately disclosed on the financial statements. Inter-partnership balances and transactions have been eliminated in consolidation. We account for investments in 50% or less-owned entities using the equity method.
These unaudited condensed 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 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 months ended March 31, 2012 and 2011 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited condensed consolidated financial statements. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. The consolidated balance sheet as of December 31, 2011 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, 2011.

2. NEW ACCOUNTING PRONOUNCEMENTS

Fair Value Measurements
In May 2011, the Financial Accounting Standards Board issued amended guidance and disclosure requirements for fair value measurements. The new guidance results in a consistent definition of fair value and common requirements for measurement of and disclosure about fair value between GAAP and International Financial Reporting Standards. These changes were effective for interim and annual periods beginning on or after December 15, 2011. Accordingly, we adopted these provisions January 1, 2012, and they did not have a material impact on our financial position, results of operations or disclosures.

3. INVENTORIES

Inventories consisted of the following:

	March 31, 2012	December 31, 2011
	(Thousands of Dollars)	
Crude oil	$270,351	$157,297
Finished products	493,826	421,288
Materials and supplies	9,831	9,200
Total	$774,008	$587,785

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4. DEBT

Revolving Credit Agreements
During the three months ended March 31, 2012, we borrowed an aggregate $436.1 million under our $1.2 billion five-year revolving credit agreement (the 2007 Revolving Credit Agreement) to fund working capital requirements, our capital expenditures and distributions. Additionally, we repaid $203.9 million during the three months ended March 31, 2012. The 2007 Revolving Credit Agreement bears interest, at our option, based on either an alternative base rate or a LIBOR-based rate. As of March 31, 2012, our weighted average borrowing interest rate was 0.8%, and we had $411.6 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 any 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. As of March 31, 2012, our consolidated debt coverage ratio was 4.6x.

NuStar Logistics' 4.75% Senior Notes
On February 2, 2012, NuStar Logistics issued $250.0 million of 4.75% senior notes under our May 13, 2010 shelf registration statement. The net proceeds of $247.4 million were used to repay the outstanding principal amount of NuPOP's 7.75% senior notes due February 15, 2012. The interest on the 4.75% senior notes is payable semi-annually in arrears on February 1 and August 1 of each year beginning on August 1, 2012. The notes will mature on February 1, 2022. The 4.75% senior notes do not have sinking fund requirements. These notes rank equally with existing senior unsecured indebtedness of NuStar Logistics and contain restrictions on NuStar Logistics' ability to incur secured indebtedness unless the same security is also provided for the benefit of holders of the senior notes. In addition, the senior notes limit NuStar Logistics' ability to incur indebtedness secured by certain liens and to engage in certain sale-leaseback transactions. At the option of NuStar Logistics, the 4.75% senior notes may be redeemed in whole or in part at any time at a redemption price, which includes a make-whole premium, plus accrued and unpaid interest to the redemption date. The 4.75% senior notes are fully and unconditionally guaranteed by NuStar Energy and NuPOP.

Gulf Opportunity Zone Revenue Bonds
The Parish of St. James, Louisiana issued, pursuant to the Gulf Opportunity Zone Act of 2005, tax-exempt revenue bonds in 2010 and 2011 (GoZone Bonds) associated with our St. James terminal expansions. The GoZone Bonds bear interest based on a weekly tax-exempt bond market interest rate, and we pay interest monthly. The interest rate was 0.1% as of March 31, 2012. The proceeds are deposited with a trustee and disbursed to us upon our request for reimbursement of expenditures related to our St. James terminal expansions. We include the amount remaining in trust related to the GoZone Bonds in "Other long-term assets, net," and the amount of bonds issued in "Long-term debt, less current portion" in our consolidated balance sheets. For the three months ended March 31, 2012, we received $18.0 million from the trustee. As of March 31, 2012, the amount remaining in trust totaled $155.3 million.

Lines of Credit
As of March 31, 2012, 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, 2012. During the three months ended March 31, 2012, we borrowed and repaid $56.4 million related to this line of credit.

5. COMMITMENTS AND CONTINGENCIES

Contingencies

We have contingent liabilities resulting from various litigation, claims and commitments, the most significant of which is 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, 2012, we have accrued $43.6 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. We reached an agreement to settle the claims of the United States government with respect to the Otis AFB pipeline and to resolve the underlying dispute between Kaneb and Grace. Pursuant to the settlement, we agreed to pay $11.7 million plus interest to the United States. The settlement was approved by the United States Bankruptcy Court for the District of Delaware and a proposed consent decree has been filed with the United States District Court for the District of Massachusetts. We are hopeful that the consent decree will be entered and that the settlement will be finalized in the near term.

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.

6. 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. We consider counterparty credit risk and our own credit risk in the determination of all estimated fair values.

Product Imbalances
We value our assets and liabilities related to product imbalances using quoted market prices in active markets as of the reporting date.

Interest Rate Swaps
We estimate the fair value of both our fixed-to-floating and forward-starting interest rate swaps using discounted cash flows, which use observable inputs such as time to maturity and market interest rates.

Commodity Derivatives

We base the fair value of certain of our commodity derivative instruments on quoted prices on an exchange; accordingly, we include these in Level 1 of the fair value hierarchy. We also have derivative instruments for which we determine fair value using industry pricing services and other observable inputs, such as quoted prices on an exchange for similar derivative instruments. Therefore, we include these derivative instruments in Level 2 of the fair value hierarchy. We have consistently applied these valuation techniques in all periods presented. See Note 7. Derivatives and Risk Management Activities for a discussion of our derivative instruments.

The following assets and liabilities are measured at fair value:

	March 31, 2012			
	Level 1	Level 2	Level 3	Total
	(Thousands of Dollars)			
Other current assets:				
Product imbalances	$1,661	$—	$—	$1,661
Commodity derivatives	21,880	329	—	22,209
Other long-term assets, net:				
Commodity derivatives	—	5,377	—	5,377
Interest rate swaps	—	581	—	581