MAGELLAN MIDSTREAM PARTNERS LP
Form 10-Q
November 01, 2018

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, 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 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 every Interactive Data File required to be submitted 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

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

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 x

As of October 31, 2018, there were 228,195,160 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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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,	
	2017	2018	2017	2018
Transportation and terminals revenue	$446,935	$488,775	$1,272,845	$1,392,960
Product sales revenue	121,010	144,403	548,634	552,792
Affiliate management fee revenue	4,903	4,842	12,883	15,138
Total revenue	572,848	638,020	1,834,362	1,960,890
Costs and expenses:				
Operating	165,368	172,115	442,254	475,256
Cost of product sales	121,819	120,510	440,670	473,781
Depreciation and amortization	49,909	56,228	146,103	161,726
General and administrative	37,202	47,389	120,876	147,235
Total costs and expenses	374,298	396,242	1,149,903	1,257,998
Earnings of non-controlled entities	31,151	53,795	78,173	130,843
Operating profit	229,701	295,573	762,632	833,735
Interest expense	51,895	55,133	154,653	168,535
Interest capitalized	(3,424)	(3,099)	(10,804)	(13,354)
Interest income	(240)	(501)	(788)	(1,460)
Gain on sale of asset	(18,505)	(353,797)	(18,505)	(353,797)
Other expense	549	1,694	3,762	10,299
Income before provision for income taxes	199,426	596,143	634,314	1,023,512
Provision for income taxes	926	1,609	2,678	3,659
Net income	$198,500	$594,534	$631,636	$1,019,853
Basic net income per limited partner unit	$0.87	$2.60	$2.77	$4.47
Diluted net income per limited partner unit	$0.87	$2.60	$2.77	$4.46
Weighted average number of limited partner units outstanding used for basic net income per unit calculation	228,199	228,397	228,167	228,368
Weighted average number of limited partner units outstanding used for diluted net income per unit calculation	228,260	228,449	228,222	228,412

See notes to consolidated financial statements.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2018	2017	2018
Net income	$198,500	$594,534	$631,636	$1,019,853
Other comprehensive income:				
Derivative activity:				
Net gain (loss) on cash flow hedges	(228)	6,852	(1,735)	13,963
Reclassification of net loss on cash flow hedges to income	740	740	2,219	2,219
Changes in employee benefit plan assets and benefit obligations recognized in other comprehensive income:				
Net actuarial loss	—	—	—	(5,291)
Amortization of prior service credit	(45)	(45)	(136)	(136)
Amortization of actuarial loss	1,568	1,806	4,779	8,623
Settlement cost	289	—	2,015	—
Total other comprehensive income	2,324	9,353	7,142	19,378
Comprehensive income	$200,824	$603,887	$638,778	$1,039,231

See notes to consolidated financial statements.

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

	December 31, 2017	September 30, 2018 (Unaudited)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 160,840	$ 217,423
Trade accounts receivable	138,779	137,618
Other accounts receivable	14,561	24,025
Inventory	182,345	179,366
Energy commodity derivatives deposits	36,690	47,354
Other current assets	63,396	66,221
Total current assets	596,611	672,007
Property, plant and equipment	7,235,468	7,570,759
Less: accumulated depreciation	1,682,633	1,835,824
Net property, plant and equipment	5,552,835	5,734,935
Investments in non-controlled entities	1,082,511	1,005,392
Long-term receivables	27,676	23,520
Goodwill	53,260	53,260
Other intangibles (less accumulated amortization of $1,389 and $2,493 at December 31, 2017 and September 30, 2018, respectively)	52,764	51,660
Restricted cash	15,228	42,807
Other noncurrent assets	13,490	12,087
Total assets	$ 7,394,375	$ 7,595,668
LIABILITIES AND PARTNERS’ CAPITAL		
Current liabilities:		
Accounts payable	$ 104,852	$ 137,169
Accrued payroll and benefits	56,261	53,285
Accrued interest payable	70,657	49,309
Accrued taxes other than income	51,343	52,307
Environmental liabilities	6,235	10,537
Deferred revenue	117,795	121,247
Accrued product liabilities	96,159	80,195
Energy commodity derivatives contracts, net	25,694	32,244
Current portion of long-term debt, net	250,974	552,898
Other current liabilities	56,540	37,873
Total current liabilities	836,510	1,127,064
Long-term debt, net	4,273,518	3,718,607
Long-term pension and benefits	111,305	125,088
Other noncurrent liabilities	30,350	64,425
Environmental liabilities	13,039	13,064
Commitments and contingencies		
Partners’ capital:		
Limited partner unitholders (228,025 units and 228,195 units outstanding at December 31, 2017 and September 30, 2018, respectively)	2,267,231	2,665,620

Accumulated other comprehensive loss	(137,578)	(118,200)
Total partners' capital	2,129,653	2,547,420
Total liabilities and partners' capital	$ 7,394,375	$ 7,595,668

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, 2017			2018		
Operating Activities:						
Net income	$	631,636		$	1,019,853	
Adjustments to reconcile net income to net cash provided by operating activities:						
Depreciation and amortization expense	146,103			161,726		
Gain on sale and retirement of assets	(10,924		)	(347,541		)
Earnings of non-controlled entities	(78,173		)	(130,843		)
Distributions from operations of non-controlled entities	97,691			147,950		
Equity-based incentive compensation expense	14,183			24,612		
Settlement cost, amortization of prior service credit and actuarial loss	6,658			8,487		
Changes in operating assets and liabilities:						
Trade accounts receivable and other accounts receivable	(14,413		)	(8,303		)
Inventory	(34,384		)	2,979		
Energy commodity derivatives contracts, net of derivatives deposits	1,135			(4,505		)
Accounts payable	15,576			27,498		
Accrued payroll and benefits	(5,608		)	(2,976		)
Accrued interest payable	(23,386		)	(21,348		)
Accrued taxes other than income	(322		)	964		
Accrued product liabilities	67,972			(15,964		)
Deferred revenue	14,806			5,353		
Current and noncurrent environmental liabilities	(3,352		)	4,327		

Other current and noncurrent assets and liabilities	(11,497		)	(8,488		)
Net cash provided by operating activities	813,701			863,781		
Investing Activities:						
Additions to property, plant and equipment, net[1]	(418,239		)	(374,320		)
Proceeds from sale and disposition of assets	44,303			579,448		
Investments in non-controlled entities	(114,078		)	(147,048		)
Distributions from returns of investments in non-controlled entities	52,738			1,786		
Deposits received from undivided joint interest third party	—			41,571		
Net cash provided (used) by investing activities	(435,276		)	101,437		
Financing Activities:						
Distributions paid	(596,854		)	(642,370		)
Net commercial paper borrowings	218,984			—		
Payments on notes	—			(250,000		)
Debt placement costs	—			(326		)
Net receipt on financial derivatives	—			20,925		
Payments associated with settlement of equity-based incentive compensation	(13,875		)	(9,285		)
Net cash used by financing activities	(391,745		)	(881,056		)
Change in cash, cash equivalents and restricted cash	(13,320		)	84,162		
Cash, cash equivalents and restricted cash at beginning of period	14,701			176,068		
Cash, cash equivalents and restricted cash at end of period	$	1,381		$	260,230	
Supplemental non-cash investing and financing activities:						
Contribution of property, plant and	$	93,051		$	—	

equipment to a non-controlled entity						
Issuance of limited partner units in settlement of equity-based incentive plan awards	$	1,669		$	120	
(1) Additions to property, plant and equipment	$	(443,439	)	$	(375,599	)
Changes in accounts payable and other current liabilities related to capital expenditures	25,200			1,279		
Additions to property, plant and equipment, net	$	(418,239	)	$	(374,320	)

See notes to consolidated financial statements.

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. Magellan Midstream Partners, L.P. is a Delaware limited partnership and its 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 its 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, 2018, 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 2,200 miles of crude oil pipelines, our condensate splitter and storage facilities with an aggregate storage capacity of approximately 33 million barrels, of which approximately 21 million barrels are used for contract 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, aviation fuel, kerosene 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 typically blended with other refined products as required by government mandates; and

- ammonia is primarily used as a nitrogen fertilizer.

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

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, 2017, 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, 2018, the results of operations for the three and nine months ended September 30, 2017 and 2018 and cash flows for the nine months ended September 30, 2017 and 2018. The results of operations for the nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year ending December 31, 2018 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 refined products pipeline system, 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, 2017.

Reclassifications. Prior year amounts related to restricted cash have been reclassified to conform with the current period’s presentation.

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.

Restricted Cash

Restricted cash includes cash held by us, which is contractually required to be used for the construction of fixed assets, and is unavailable for general use. It is classified as noncurrent due to its designation to be used for the construction of noncurrent assets.

Correction of Actuarial Valuation Error

In first quarter 2018, an error was discovered in our third-party actuary's valuation of our pension liabilities and net periodic pension expenses dating back to 2010. The impacts of the error were not material to any of our prior period financial statements and the cumulative impact was corrected with a one-time adjustment in the first quarter of 2018. As a result, during first quarter 2018, net periodic pension expenses were increased by $16.0 million ($5.7 million operating expense, $3.4 million general and administrative ("G&A") costs and $6.9 million other expense below operating profit on our consolidated statements of income). In addition, long-term pension and benefits was increased $18.8 million and accumulated other comprehensive loss was increased by $2.8 million on our consolidated balance sheets.

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

New Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("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. For public companies, this ASU is effective for fiscal years that start after December 15, 2018, and early adoption is permitted. This standard will not have a material impact on our consolidated statements of income. Based on our current population of leases, we expect the impact of this ASU to increase our assets and liabilities by approximately $80.0 million due to the recognition of right of use assets and lease liabilities.

New Accounting Pronouncements - Adopted January 1, 2018

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities. This update changes GAAP's hedge accounting requirements to simplify some of the specialized treatment's most complex areas. These simplifications are intended to expand opportunities to use hedge accounting and better align the accounting treatment with existing risk management activities. The ASU is effective for public companies starting after December 15, 2018, and we early-adopted the new standard on January 1, 2018. The adoption of this ASU did not have a material impact on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments: A Consensus of the FASB Emerging Issues Task Force. This ASU includes a requirement to make an accounting policy election to classify distributions received from equity method investees under either (1) the cumulative earnings approach, where distributions in excess of equity earnings are considered a return of capital and classified as cash inflows from investing activities, or (2) the nature of the distribution approach, where each distribution is evaluated on the basis of the source of the payment and classified as either operating or investing cash inflows. We adopted this standard on January 1, 2018 using the retrospective transition method and made an accounting policy election to use the nature of the distribution approach, which resulted in the following adjustments to our September 30, 2017 comparative statement of cash flows (in thousands):

	Nine Months Ended September 30, 2017, as Reported	ASU 2016-15 Adjustment	Nine Months Ended September 30, 2017, as Adjusted
Operating activities:			
Distributions from operations of non-controlled entities	$78,562	$ 19,129	$97,691
Net cash provided by operating activities	$794,572	$ 19,129	$813,701

Investing activities:			
Distributions from returns of investments in non-controlled entities	$71,867	$(19,129)	$52,738
Net cash used by investing activities	$(416,147)	$(19,129)	$(435,276)

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606). This ASU amends the existing accounting standards for revenue recognition and is based on the principle that revenue should be recognized to depict the transfer of goods or services to a customer at an amount that reflects the consideration a company expects to receive in exchange for those goods or services. On January 1, 2018, we adopted the new Accounting Standards Codification ("ASC") 606, Revenue from Contracts with Customers and all related

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

amendments using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of partners' capital. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods.

The cumulative effect of the changes made to our consolidated January 1, 2018 balance sheet resulting from the adoption of the new revenue standard was as follows (in thousands):

	Balance at December 31, 2017	Adjustments Due to ASU 2014-09	Balance at January 1, 2018
Assets:			
Property, plant and equipment	$7,235,468	$ 8,516	$7,243,984
Accumulated depreciation	(1,682,633)	(325)	(1,682,958)
Net property, plant and equipment	$5,552,835	$ 8,191	$5,561,026
Investments in non-controlled entities	$1,082,511	$ 502	$1,083,013
Liabilities:			
Deferred revenue	$117,795	$ (1,901)	$115,894
Other noncurrent liabilities	$30,350	$ 4,619	$34,969
Partners' capital:			
Limited partner unitholders	$2,267,231	$ 5,975	$2,273,206

The primary changes impacting our financial statements under the new revenue standard include the requirement for us to estimate deficiencies in our customers' use of our services contracted as minimum commitments and adjust the amount of revenue recognized in proportion to our customers' pattern of exercised rights. This change results in accelerating the timing of revenue recognized for specific contracts for which we estimate our customers will not ship their minimum commitments. In addition, we periodically receive payments from customers seeking to expand their access to our pipeline systems and terminals. Prior to the adoption of the new revenue standard, these payments were recorded as reductions to our property, plant and equipment ("PP&E") expenditures. Under the new revenue standard, these payments are recorded to deferred revenue and other noncurrent liabilities and are recognized as revenue in proportion to the related services provided. The impact of this change increases our revenues, contract liabilities, PP&E and depreciation expense. We expect the impact of the adoption of the new revenue standard, including these changes, to be immaterial to our net income on an ongoing basis.

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

2. Revenue from Contracts with Customers

Adoption of ASC 606, Revenue from Contracts with Customers

The table below provides the amount by which financial statement line items are affected in the current reporting period by the application of the new revenue standard, as compared with the guidance that was in effect before the change (in thousands):

	As Reported	Amounts without adoption of ASC 606	Effect of Change Higher/(Lower)
Statements of Income:			
	Three Months Ended September 30, 2018		
Transportation and terminals revenue	$488,775	$486,801	$ 1,974
Depreciation and amortization	$56,228	$56,108	$ 120
	Nine Months Ended September 30, 2018		
Transportation and terminals revenue	$1,392,960	$1,383,404	$ 9,556
Depreciation and amortization	$161,726	$161,486	$ 240
Balance Sheet:			
	As of September 30, 2018		
Assets:			
Property, plant and equipment	$7,570,759	$7,555,758	$ 15,001
Accumulated depreciation	1,835,824	1,835,259	565
Net property, plant and equipment	$5,734,935	$5,720,499	$ 14,436
Investments in non-controlled entities	$1,005,392	$1,004,890	$ 502
Liabilities:			
Deferred revenue	$121,247	$129,458	$ (8,211)
Other noncurrent liabilities	$64,425	$56,567	$ 7,858
Partners’ capital:			
Limited partner unitholders	$2,665,620	$2,650,329	$ 15,291

Revenue recognition policies

Revenue is recognized upon the satisfaction of each performance obligation required by our customer contracts. Transportation and terminals revenue is recognized over time as our customers receive the benefits of our service as it is performed on their behalf using an output method based on actual deliveries. Revenue for our storage services is recognized over time using an output method based on the capacity of storage under contract with our customers. Product sales revenue is recognized at a point in time when our customers take control of the commodities purchased.

We record back-to-back purchases and sales of petroleum products where we are acting as an agent on a net basis.

We recognize pipeline transportation revenue for crude oil and ammonia shipments when our customers' product arrives at the customer-designated destination. For shipments of refined products under published tariffs that combine transportation and terminalling services, we recognize revenue when our customers take delivery of their product from our system. For shipments where terminalling services are not included in the tariff, we recognize revenue when our customers' product arrives at the customer-designated destination. We have certain contracts that require counterparties to ship a minimum volume over an agreed-upon time period, which are contracted as minimum dollar or volume commitments. Revenue pursuant to these take-or-pay contracts is recognized when the customers utilize their committed volumes. Additionally, when we estimate that the customers will not utilize all or a portion of their committed volumes, we recognize revenue in proportion to the pattern of exercised rights for the respective commitment period.

Our interstate common carrier petroleum products pipeline operations are subject to rate regulation by the Federal Energy Regulatory Commission ("FERC") under the Interstate Commerce Act, the Energy Policy Act of 1992 and rules and orders promulgated pursuant thereto. FERC regulation requires that interstate pipeline rates be filed with the FERC, be posted publicly and be nondiscriminatory and "just and reasonable." The rates on approximately 40% of the shipments on our refined products pipeline system are regulated by the FERC primarily through an index methodology. As an alternative to cost-of-service or index-based rates, interstate pipeline companies may establish rates by obtaining authority to charge market-based rates in competitive markets or by negotiation with unaffiliated shippers. Approximately 60% of our refined products pipeline system's markets are either subject to regulations by the states in which we operate or are approved for market-based rates by the FERC, and in both cases these rates can generally be adjusted at our discretion based on market factors. Most of the tariffs on our crude oil pipelines are established by negotiated rates that generally provide for annual adjustments in line with changes in the FERC index, subject to certain modifications.

For both our index-based rates and our market-based rates, our published tariffs serve as contracts, and shippers nominate the volume to be shipped up to a month in advance. These tariffs include provisions which allow us to deduct from our customer's inventory a small percentage of the products our customers transport on our pipeline systems. We refer to this non-monetary consideration as tender deduction revenue. We receive tender deductions from our customers as consideration for product losses during the transportation of petroleum products within our pipeline systems. Tender deduction revenue is generally recognized as transportation revenue when the customer's transported commodities reach their destination and is recorded at the fair value of the product received on the date received or the contract date, as applicable.

Product sales revenue pricing is contractually specified, and we have determined that each barrel sold represents a separate performance obligation. Transaction prices for our other services including terminalling, storage and ancillary services are typically contracted as a single performance obligation with our customers. In circumstances where multiple performance obligations are contractually required, we allocate the transaction price to the various performance obligations based on their relative standalone selling price.

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

Statement of Income Disclosures

The following tables provide details of our revenues disaggregated by key activities that comprise our performance obligations by operating segment (in thousands):

	Three Months Ended September 30, 2018				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation	$197,235	$91,086	$—	$ —	$288,321
Terminalling	46,213	2,528	616	—	49,357
Storage	25,137	29,094	33,890	(923)	87,198
Ancillary services	28,808	6,278	5,857	—	40,943
Lease revenue	2,641	16,132	4,183	—	22,956
Transportation and terminals revenue	300,034	145,118	44,546	(923)	488,775
Product sales revenue	129,926	12,666	1,811	—	144,403
Affiliate management fee revenue	351	3,463	1,028	—	4,842
Total revenue	430,311	161,247	47,385	(923)	638,020
Revenue not under the guidance of ASC 606:					
Lease revenue(1)	(2,641)	(16,132)	(4,183)	—	(22,956)
Losses from futures contracts included in product sales revenue(2)	24,253	102	—	—	24,355
Affiliate management fee revenue	(351)	(3,463)	(1,028)	—	(4,842)
Total revenue from contracts with customers under ASC 606	$451,572	$141,754	$42,174	$ (923)	$634,577

(1) Lease revenue is accounted for under ASC 840, Leases.
(2) The impact on product sales revenue from futures contracts falls under the guidance of ASC 815, Derivatives and Hedging.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Nine Months Ended September 30, 2018				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation	$548,733	$254,964	$—	$ —	$803,697
Terminalling	136,135	2,528	1,920	—	140,583
Storage	75,353	87,620	101,420	(2,753)	261,640
Ancillary services	83,055	19,512	18,928	—	121,495
Lease revenue	8,216	44,705	12,624	—	65,545
Transportation and terminals revenue	851,492	409,329	134,892	(2,753)	1,392,960
Product sales revenue	513,634	32,387	6,771	—	552,792
Affiliate management fee revenue	1,000	11,328	2,810	—	15,138
Total revenue	1,366,126	453,044	144,473	(2,753)	1,960,890
Revenue not under the guidance of ASC 606:					
Lease revenue(1)	(8,216)	(44,705)	(12,624)	—	(65,545)
Losses from futures contracts included in product sales revenue(2)	64,558	5,582	—	—	70,140
Affiliate management fee revenue	(1,000)	(11,328)	(2,810)	—	(15,138)
Total revenue from contracts with customers under ASC 606	$1,421,468	$402,593	$129,039	$ (2,753)	$1,950,347

(1) Lease revenue is accounted for under ASC 840, Leases.
(2) The impact on product sales revenue from futures contracts falls under the guidance of ASC 815, Derivatives and Hedging.

Balance Sheet Disclosures

We invoice customers on our refined products pipelines for transportation services when their product enters our system. At each period end, we record all invoiced amounts associated with products that have not yet been delivered (in-transit products) as a contract liability. This liability is presented as deferred revenue on our consolidated balance sheets. Deferred revenue is also recorded for pre-payments received in conjunction with take-or-pay contracts, storage contracts and other service offerings in which the service to our customers remains unfulfilled. Additionally, at each period end, we defer the direct costs we have incurred associated with our customers’ in-transit products as contract assets. Contract assets are presented on our consolidated balance sheets as other current assets. These direct costs are estimated based on our per-barrel direct delivery cost for the current period multiplied by the total in-transit barrels in our system at the end of the period multiplied by 50% to reflect the average transportation costs incurred for all products across all of our pipeline systems. We use 50% of the in-transit barrels because that best represents the average delivery point of all barrels in our pipeline system. These contract assets and contract liabilities are determined using judgments and assumptions that management considers reasonable.

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The following table summarizes our accounts receivable, contract assets and contract liabilities resulting from contracts with customers (in thousands):

	January 1, 2018	September 30, 2018
Accounts receivable from contracts with customers	$133,084	$ 135,269
Contract assets	$8,615	$ 8,053
Contract liabilities	$106,933	$ 119,841

For the three and nine months ended September 30, 2018, we recognized $10.7 million and $77.0 million, respectively, of transportation and terminals revenue that was recorded in deferred revenue as of January 1, 2018.

Unfulfilled Performance Obligations

We have certain contracts with customers that represent customer commitments to purchase a minimum amount of our services over specified time periods. These contracts require us to provide services to our customers in the future and result in our having unfulfilled performance obligations ("UPOs") to our customers related to the periods remaining under each contract. We have UPOs in many of our core business services, including transportation, terminalling and storage services. The UPOs will be recognized as revenue in the future as our customers utilize our services or when we estimate that our customers are not likely to use all or a portion of their commitments.

The following table provides the aggregate amount of the transaction price allocated to our UPOs as of September 30, 2018 by operating segment, including the range of years remaining on our contracts with customers and an estimate of revenues expected to be recognized over the next 12 months (dollars in thousands):

	Refined Products	Crude Oil	Marine Storage	Total
Balances at September 30, 2018	$2,176,871	$1,419,449	$341,673	$3,937,993
Remaining terms	1 - 20 years	1 - 10 years	1 - 6 years	
Estimated revenues from UPOs to be recognized in the next 12 months	$395,872	$328,844	$147,795	$872,511

In computing the value of these future revenues, we have used the current rates in effect as of September 30, 2018 and have not included any estimates for future rate changes due to changes in the FERC index or other contractually negotiated rate escalations. Our UPO balances include the full amount of our customer commitments as of September 30, 2018 through the expiration of the related contracts. The UPO balances disclosed exclude all performance obligations for which the original expected term is one year or less, the consideration is variable or the future use of our services is fully at the discretion of our customers.

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 (presented in thousands). Operating profit includes depreciation and amortization expense and G&A expense that management does not consider when evaluating the core profitability of our separate operating segments.

	Three Months Ended September 30, 2017				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$289,030	$116,305	$42,501	$ (901)	$446,935
Product sales revenue	107,175	12,370	1,465	—	121,010
Affiliate management fee revenue	353	3,703	847	—	4,903
Total revenue	396,558	132,378	44,813	(901)	572,848
Operating expenses	118,665	31,163	17,723	(2,183)	165,368
Cost of product sales	103,391	16,630	1,798	—	121,819
(Earnings) losses of non-controlled entities	700	(31,244)	(607)	—	(31,151)
Operating margin	173,802	115,829	25,899	1,282	316,812
Depreciation and amortization expense	27,469	12,584	8,574	1,282	49,909
G&A expense	23,808	9,266	4,128	—	37,202
Operating profit	$122,525	$93,979	$13,197	$ —	$229,701

	Three Months Ended September 30, 2018				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$300,034	$145,118	$44,546	$ (923)	$488,775
Product sales revenue	129,926	12,666	1,811	—	144,403
Affiliate management fee revenue	351	3,463	1,028	—	4,842
Total revenue	430,311	161,247	47,385	(923)	638,020
Operating expenses	112,279	45,195	17,178	(2,537)	172,115
Cost of product sales	106,756	11,590	2,164	—	120,510
Earnings of non-controlled entities	(3,393)	(49,420)	(982)	—	(53,795)
Operating margin	214,669	153,882	29,025	1,614	399,190
Depreciation and amortization expense	30,440	15,145	9,029	1,614	56,228
G&A expense	28,751	12,766	5,872	—	47,389
Operating profit	$155,478	$125,971	$14,124	$ —	$295,573

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Nine Months Ended September 30, 2017				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$808,818	$329,813	$136,702	$ (2,488)	$1,272,845
Product sales revenue	509,068	34,876	4,690	—	548,634
Affiliate management fee revenue	1,035	10,311	1,537	—	12,883
Total revenue	1,318,921	375,000	142,929	(2,488)	1,834,362
Operating expenses	312,911	89,991	45,753	(6,401)	442,254
Cost of product sales	396,292	37,814	6,564	—	440,670
(Earnings) losses of non-controlled entities	167	(76,388)	(1,952)	—	(78,173)
Operating margin	609,551	323,583	92,564	3,913	1,029,611
Depreciation and amortization expense	81,440	35,947	24,803	3,913	146,103
G&A expense	75,429	30,376	15,071	—	120,876
Operating profit	$452,682	$257,260	$52,690	$ —	$762,632

	Nine Months Ended September 30, 2018				
	Refined Products	Crude Oil	Marine Storage	Intersegment Eliminations	Total
Transportation and terminals revenue	$851,492	$409,329	$134,892	$ (2,753)	$1,392,960
Product sales revenue	513,634	32,387	6,771	—	552,792
Affiliate management fee revenue	1,000	11,328	2,810	—	15,138
Total revenue	1,366,126	453,044	144,473	(2,753)	1,960,890
Operating expenses	319,670	109,963	52,835	(7,212)	475,256
Cost of product sales	434,632	32,401	6,748	—	473,781
Earnings of non-controlled entities	(5,614)	(122,879)	(2,350)	—	(130,843)
Operating margin	617,438	433,559	87,240	4,459	1,142,696
Depreciation and amortization expense	89,855	40,648	26,764	4,459	161,726
G&A expense	90,825	38,127	18,283	—	147,235
Operating profit	$436,758	$354,784	$42,193	$ —	$833,735

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

4. Investments in Non-Controlled Entities

Our investments in non-controlled entities at September 30, 2018 were comprised of:

Entity	Ownership Interest
BridgeTex Pipeline Company, LLC (“BridgeTex”)	30%
Double Eagle Pipeline LLC (“Double Eagle”)	50%
HoustonLink Pipeline Company, LLC (“HoustonLink”)	50%
MVP Terminalling, LLC (“MVP”)	50%
Powder Springs Logistics, LLC (“Powder Springs”)	50%
Saddlehorn Pipeline Company, LLC (“Saddlehorn”)	40%
Seabrook Logistics, LLC (“Seabrook”)	50%
Texas Frontera, LLC (“Texas Frontera”)	50%

In September 2018, we sold a 20% interest in BridgeTex to an affiliate of OMERS Infrastructure Management, Inc. (“OMERS”), which reduced our ongoing investment in BridgeTex to a 30% interest. We received $578.5 million in cash from the sale, and we recorded a gain of $353.8 million on our consolidated statements of income. See Note 9 – Commitments and Contingencies for details regarding our indemnity to OMERS that was recorded in relation to the sale.

We serve as operator of BridgeTex, HoustonLink, MVP, Powder Springs, Saddlehorn, Texas Frontera and the pipeline activities of Seabrook. We receive fees for management services as well as reimbursement or payment to us for certain direct operational payroll and other overhead costs. The management fees we have received are reported as affiliate management fee revenue on our consolidated statements of income. Cost reimbursements we receive from these entities in connection with our operating services are included as reductions to costs and expenses on our consolidated statements of income and totaled $0.7 million and $0.9 million during the three months ended September 30, 2017 and 2018, respectively, and $3.1 million and $2.6 million during the nine months ended September 30, 2017 and 2018, respectively.

We recorded the following revenue and expense transactions from certain of these non-controlled entities in our consolidated statements of income (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2018	2017	2018
Transportation and terminals revenue:				
BridgeTex, pipeline capacity	$ 9.1	$ 9.9	$ 27.0	$ 29.5
Double Eagle, throughput revenue	$ 1.3	$ 1.0		