

NuStar Energy L.P.  
Form 10-Q  
November 09, 2007  
Table of Contents

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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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(Mark One)

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

For the quarterly period ended September 30, 2007

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 Number 1-16417

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**NUSTAR ENERGY L.P.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or other jurisdiction of  
incorporation or organization)

2330 North Loop 1604 West

San Antonio, Texas

74-2956831  
(I.R.S. Employer

Identification No.)

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(Address of principal executive offices)

78248

(Zip Code)

Telephone number: (210) 918-2000

(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. The definition of accelerated filer and large accelerated filer is in Rule 12b-2 of the Securities Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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The number of common units outstanding as of November 1, 2007 was 46,809,749.

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**Table of Contents**

**NUSTAR ENERGY L.P. AND SUBSIDIARIES**

**FORM 10-Q**

**TABLE OF CONTENTS**

**PART I FINANCIAL INFORMATION**

|         |  |    |
|---------|--|----|
| Item 1. | <u>Financial Statements:</u>   |    |
|         | <u>Consolidated Balance Sheets as of September 30, 2007 and December 31, 2006</u>                        | 3  |
|         | <u>Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2007 and 2006</u> | 4  |
|         | <u>Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2007 and 2006</u>       | 5  |
|         | <u>Condensed Notes to Consolidated Financial Statements</u>  | 6  |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>             | 26 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u>  | 42 |
| Item 4. | <u>Controls and Procedures</u>   | 44 |

**PART II OTHER INFORMATION**

|          |                          |    |
|----------|--------------------------|----|
| Item 1.  | <u>Legal Proceedings</u> | 45 |
| Item 1A. | <u>Risk Factors</u>      | 45 |
| Item 6.  | <u>Exhibits</u>          | 45 |
|          | <u>SIGNATURES</u>        | 46 |

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(Thousands of Dollars, Except Unit Data)

|   | September 30,<br>2007<br>(Unaudited) | December 31,<br>2006 |
|---|--------------------------------------|----------------------|
| <b>Assets</b>   |                                      |                      |
| Current assets:   |                                      |                      |
| Cash and cash equivalents   | \$ 76,371                            | \$ 68,838            |
| Accounts receivable, net of allowance for doubtful accounts of \$462 and \$1,220 as of September 30, 2007 and December 31, 2006, respectively | 124,118                              | 105,976              |
| Receivable from related party   | 1,126                                |                      |
| Inventories   | 33,214                               | 16,979               |
| Other current assets  | 33,062                               | 21,205               |
| <b>Total current assets</b>   | <b>267,891</b>                       | <b>212,998</b>       |
| Property and equipment, at cost   | 2,866,120                            | 2,694,358            |
| Accumulated depreciation and amortization   | (426,151)                            | (349,223)            |
| Property and equipment, net   | 2,439,969                            | 2,345,135            |
| Intangible assets, net  | 49,442                               | 53,532               |
| Goodwill  | 786,221                              | 774,441              |
| Investment in joint ventures  | 78,503                               | 74,077               |
| Deferred income tax asset   | 11,503                               | 11,342               |
| Deferred charges and other assets, net  | 19,076                               | 22,683               |
| <b>Total assets</b>   | <b>\$ 3,652,605</b>                  | <b>\$ 3,494,208</b>  |
| <b>Liabilities and Partners Equity</b>  |                                      |                      |
| Current liabilities:  |                                      |                      |
| Current portion of long-term debt   | \$ 614                               | \$ 647               |
| Payable to related party  |                                      | 2,315                |
| Notes payable   | 1,247                                |                      |
| Accounts payable  | 89,559                               | 86,307               |
| Accrued interest payable  | 11,278                               | 17,528               |
| Accrued liabilities   | 39,018                               | 37,651               |
| Taxes other than income taxes   | 12,856                               | 10,219               |
| Income taxes payable  | 3,717                                | 2,068                |
| <b>Total current liabilities</b>  | <b>158,289</b>                       | <b>156,735</b>       |
| Long-term debt, less current portion  | 1,513,497                            | 1,353,720            |
| Long-term payable to related party  | 5,700                                | 5,749                |
| Deferred income tax liability   | 36,330                               | 32,926               |
| Other long-term liabilities   | 65,621                               | 69,397               |

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### Commitments and contingencies (Note 5)

#### Partners' equity:

|   |              |              |
|---|--------------|--------------|
| Limited partners (46,809,749 common units outstanding as of September 30, 2007 and December 31, 2006) | 1,806,535    | 1,830,047    |
| General partner   | 39,091       | 38,815       |
| Accumulated other comprehensive income  | 27,542       | 6,819        |
| Total partners' equity  | 1,873,168    | 1,875,681    |
| Total liabilities and partners' equity  | \$ 3,652,605 | \$ 3,494,208 |

See Condensed Notes to Consolidated Financial Statements.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****(Unaudited, Thousands of Dollars, Except Unit and Per Unit Data)**

|  | Three Months Ended<br>September 30, |                   | Nine Months Ended<br>September 30, |                   |
|--|-------------------------------------|-------------------|------------------------------------|-------------------|
|  | 2007                                | 2006              | 2007                               | 2006              |
| <b>Revenues:</b>   |                                     |                   |                                    |                   |
| Services revenues:   |                                     |                   |                                    |                   |
| Third parties  | \$ 185,979                          | \$ 92,679         | \$ 503,321                         | \$ 267,613        |
| Related party  |                                     | 69,209            |                                    | 194,298           |
| <b>Total services revenues</b>   | <b>185,979</b>                      | <b>161,888</b>    | <b>503,321</b>                     | <b>461,911</b>    |
| Product sales  | 208,563                             | 129,135           | 508,551                            | 383,084           |
| <b>Total revenues</b>  | <b>394,542</b>                      | <b>291,023</b>    | <b>1,011,872</b>                   | <b>844,995</b>    |
| <b>Costs and expenses:</b>   |                                     |                   |                                    |                   |
| Cost of product sales  | 199,023                             | 117,759           | 475,011                            | 350,260           |
| Operating expenses:  |                                     |                   |                                    |                   |
| Third parties  | 68,823                              | 57,753            | 191,762                            | 164,168           |
| Related party  | 23,158                              | 24,749            | 66,875                             | 68,559            |
| <b>Total operating expenses</b>  | <b>91,981</b>                       | <b>82,502</b>     | <b>258,637</b>                     | <b>232,727</b>    |
| General and administrative expenses:   |                                     |                   |                                    |                   |
| Third parties  | 7,819                               | 3,425             | 21,287                             | 9,556             |
| Related party  | 8,299                               | 7,963             | 27,320                             | 20,767            |
| <b>Total general and administrative expenses</b>                             | <b>16,118</b>                       | <b>11,388</b>     | <b>48,607</b>                      | <b>30,323</b>     |
| Depreciation and amortization expense  | 29,534                              | 24,994            | 84,736                             | 74,022            |
| <b>Total costs and expenses</b>  | <b>336,656</b>                      | <b>236,643</b>    | <b>866,991</b>                     | <b>687,332</b>    |
| <b>Operating income</b>  | <b>57,886</b>                       | <b>54,380</b>     | <b>144,881</b>                     | <b>157,663</b>    |
| Equity earnings from joint ventures  | 1,613                               | 1,464             | 4,970                              | 4,514             |
| Interest expense, net  | (19,381)                            | (16,606)          | (57,687)                           | (48,906)          |
| Other income, net  | 14,666                              | 1,317             | 38,915                             | 1,276             |
| <b>Income from continuing operations before income tax expense (benefit)</b> | <b>54,784</b>                       | <b>40,555</b>     | <b>131,079</b>                     | <b>114,547</b>    |
| Income tax expense (benefit)   | 3,571                               | (614)             | 9,046                              | 1,997             |
| <b>Income from continuing operations</b>                                     | <b>51,213</b>                       | <b>41,169</b>     | <b>122,033</b>                     | <b>112,550</b>    |
| <b>Loss from discontinued operations, net of income tax</b>                  |                                     |                   |                                    | <b>(377)</b>      |
| <b>Net income</b>  | <b>51,213</b>                       | <b>41,169</b>     | <b>122,033</b>                     | <b>112,173</b>    |
| Less net income applicable to general partner                                | (5,842)                             | (4,310)           | (15,414)                           | (12,550)          |
| <b>Net income applicable to limited partners</b>                             | <b>\$ 45,371</b>                    | <b>\$ 36,859</b>  | <b>\$ 106,619</b>                  | <b>\$ 99,623</b>  |
| <b>Weighted average number of basic units outstanding</b>                    | <b>46,809,749</b>                   | <b>46,809,749</b> | <b>46,809,749</b>                  | <b>46,809,749</b> |

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**Income (loss) per unit applicable to limited partners:**

|  |           |             |           |             |           |             |           |             |
|--|-----------|-------------|-----------|-------------|-----------|-------------|-----------|-------------|
| Continuing operations                                      | \$        | 0.97        | \$        | 0.79        | \$        | 2.28        | \$        | 2.14        |
| Discontinued operations                                    |           |             |           |             |           |             |           | (0.01)      |
| <b>Net income</b>  | <b>\$</b> | <b>0.97</b> | <b>\$</b> | <b>0.79</b> | <b>\$</b> | <b>2.28</b> | <b>\$</b> | <b>2.13</b> |
| Cash distributions per unit applicable to limited partners | \$        | 0.985       | \$        | 0.915       | \$        | 2.850       | \$        | 2.685       |

See Condensed Notes to Consolidated Financial Statements.



**Table of Contents**

**NUSTAR ENERGY L.P. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited, Thousands of Dollars)

|   | Nine Months Ended<br>September 30, |                  |
|---|------------------------------------|------------------|
|   | 2007                               | 2006             |
| <b>Cash Flows from Operating Activities:</b>                                      |                                    |                  |
| Net income  | \$ 122,033                         | \$ 112,173       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |                  |
| Depreciation and amortization expense   | 84,736                             | 74,022           |
| Equity earnings from joint ventures   | (4,970)                            | (4,601)          |
| Distributions from joint ventures   | 544                                | 4,052            |
| Changes in current assets and current liabilities (Note 9)                        | (43,096)                           | 3,517            |
| Other, net  | (12,405)                           | (7,184)          |
| <b>Net cash provided by operating activities</b>                                  | <b>146,842</b>                     | <b>181,979</b>   |
| <b>Cash Flows from Investing Activities:</b>                                      |                                    |                  |
| Reliability capital expenditures  | (23,554)                           | (21,334)         |
| Strategic and other capital expenditures  | (146,876)                          | (48,981)         |
| Acquisition   |                                    | (12,827)         |
| Investment in other noncurrent assets   | (62)                               | (9,404)          |
| Proceeds from sale of assets  | 4,784                              | 70,192           |
| Proceeds from sale of net profit interest in coal mine                            | 7,250                              |                  |
| Proceeds from insurance settlement  | 250                                | 3,661            |
| Distributions in excess of equity earnings from joint ventures                    |                                    | 472              |
| Other   | 23                                 | 912              |
| <b>Net cash used in investing activities</b>                                      | <b>(158,185)</b>                   | <b>(17,309)</b>  |
| <b>Cash Flows from Financing Activities:</b>                                      |                                    |                  |
| Proceeds from long-term debt borrowings   | 440,515                            | 59,000           |
| Long-term debt repayments   | (280,067)                          | (48,480)         |
| Repayments of notes payable   | (6,106)                            |                  |
| Increase (decrease) in cash book overdrafts                                       | 5,664                              | (8,216)          |
| Contributions from general partner  |                                    | 352              |
| Distributions to unitholders and general partner                                  | (145,269)                          | (135,596)        |
| Other   | (12)                               | (395)            |
| <b>Net cash provided by (used in) financing activities</b>                        | <b>14,725</b>                      | <b>(133,335)</b> |
| Effect of foreign exchange rate changes on cash                                   | 4,151                              | (660)            |
| <b>Net increase in cash and cash equivalents</b>                                  | <b>7,533</b>                       | <b>30,675</b>    |
| Cash and cash equivalents at the beginning of the period                          | 68,838                             | 36,054           |
| <b>Cash and cash equivalents at the end of the period</b>                         | <b>\$ 76,371</b>                   | <b>\$ 66,729</b> |

See Condensed Notes to Consolidated Financial Statements.



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**Table of Contents**

**NUSTAR ENERGY L.P. AND SUBSIDIARIES**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. ORGANIZATION, OPERATIONS AND ACCOUNTING PRONOUNCEMENTS**

***Organization***

NuStar Energy L.P. is a publicly traded Delaware limited partnership primarily engaged in the crude oil and refined product transportation, terminalling and storage business in the United States, the Netherland Antilles, Canada, Mexico, the Netherlands and the United Kingdom.

As used in this report, references to we, us, our or the Partnership collectively refer, depending on the context, to NuStar Energy L.P. or a wholly owned subsidiary of NuStar Energy L.P.

These unaudited consolidated financial statements include the accounts of the Partnership and subsidiaries in which the Partnership has a controlling interest. Intercompany balances and transactions have been eliminated in consolidation. Investments in 50% or less owned entities are accounted for using the equity method of accounting.

These unaudited 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 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. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three and nine months ended September 30, 2007 and 2006 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited consolidated financial statements. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The consolidated balance sheet as of December 31, 2006 has been derived from the audited consolidated financial statements as of that date. You should read these consolidated financial statements in conjunction with the consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2006.

NuStar GP Holdings, LLC (NuStar GP Holdings), a publicly held Delaware limited liability company, owns our general partner, which is represented by a 2% general partner interest. NuStar GP Holdings, through various affiliates, also owns an approximate 21.4% limited partner interest, resulting in a combined partnership ownership of 23.4%. Our remaining 76.6% limited partnership interests are held by public unitholders.

***Operations***

Our operations are managed by NuStar GP, LLC, a wholly owned subsidiary of NuStar GP Holdings.

We conduct our operations through our subsidiaries, primarily NuStar Logistics, L.P. (NuStar Logistics) and Kaneb Pipe Line Operating Partnership, L.P. (KPOP). We have five business segments: refined product terminals, refined product pipelines, crude oil pipelines, crude oil storage tanks and an other segment.

***New Accounting Pronouncements***

***FASB Statement 159***

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. Statement No. 159 creates a fair value option under which an entity may irrevocably elect fair value as the initial and subsequent measurement attribute for certain financial assets and financial liabilities on an instrument-by-instrument basis, with changes in fair value recognized in earnings as those changes occur. The adoption of Statement No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the effect of Statement No. 159.

***FASB Interpretation No. 48***

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of FASB Statement No. 109 (FIN 48). FIN 48 clarifies the accounting for uncertain income tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*,

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

by defining a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. An enterprise recognizes a tax position if it is more-likely-than-not that the tax position will be sustained, based on the technical merits of the position, upon examination. An uncertain tax position is measured in the financial statements at the largest amount of benefit that is more-likely-than-not to be realized. We adopted FIN 48 effective January 1, 2007, which did not affect our financial position or results of operations. We had no unrecognized tax benefits as of January 1, 2007 or September 30, 2007.

NuStar Energy L.P. or certain of its subsidiaries file income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. For U.S. federal and state purposes, tax years subject to examination are 2002 through 2006 and for our major non-U.S. jurisdictions, tax years subject to examination are 2000 through 2006.

***EITF Issue No. 06-3***

In June 2006, the FASB ratified its consensus on EITF Issue No. 06-3, How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (EITF No. 06-3). EITF No. 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include sales, use, value added, and some excise taxes. These taxes should be presented on either a gross or a net basis, and if reported on a gross basis, a company should disclose amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented. We present taxes on a net basis in our consolidated financial statements. We adopted EITF No. 06-3 effective January 1, 2007, which had no impact on our financial position or results of operations.

***Reclassifications***

Certain previously reported amounts in the 2006 consolidated financial statements have been reclassified to conform to the 2007 presentation.

**2. ACQUISITIONS*****St. James Crude Oil Storage Facility***

On December 1, 2006, we acquired a crude oil storage and blending facility in St. James, Louisiana from Koch Supply and Trading, L.P. for approximately \$141.7 million (the St. James Acquisition). The facility includes 17 crude oil tanks with a total capacity of approximately 3.3 million barrels. Additionally, the facility has three docks with barge and ship access. The facility is located on the west bank of the Mississippi River approximately 60 miles west of New Orleans. We funded the acquisition with borrowings under our revolving credit agreement. The results of operations are included in the refined product terminal segment.

The acquisition of the St. James crude facility was accounted for using the purchase method. The purchase price and purchase price allocation were as follows (in thousands):

|                                  |                   |
|----------------------------------|-------------------|
| Cash paid for St. James Terminal | \$ 140,900        |
| Transaction costs                | 759               |
| <b>Total</b>                     | <b>\$ 141,659</b> |
| Current assets                   | \$ 53             |
| Property and equipment           | 126,258           |

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|                   |            |
|-------------------|------------|
| Goodwill          | 13,898     |
| Intangible assets | 1,450      |
| Total             | \$ 141,659 |

Since the effect of the St. James Acquisition was not significant, we have not presented pro forma financial information for the three and nine months ended September 30, 2006 giving effect to the St. James Acquisition as of January 1, 2006.

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**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****3. PRODUCT IMBALANCES**

Product imbalances occur when customers deliver more or less refined product volumes into our pipelines than they are entitled to receive. We value assets and liabilities related to product imbalances at current market prices. Included in Other current assets on the consolidated balance sheets are \$10.9 million and \$9.9 million of product imbalance assets as of September 30, 2007 and December 31, 2006, respectively. Included in Accrued liabilities on the consolidated balance sheets are \$8.9 million and \$7.8 million of product imbalance liabilities as of September 30, 2007 and December 31, 2006, respectively.

**4. LONG-TERM DEBT*****Extension of Maturity Date***

In accordance with the terms of our \$600 Million Revolving Credit Agreement (Revolving Credit Agreement) and \$525 Million Term Loan Agreement (Term Loan Agreement), we requested a one-year extension to the maturity dates of those agreements. In June 2007, the lenders consented to our request thereby extending the maturity dates of our Revolving Credit Agreement and our Term Loan Agreement to May 31, 2012.

***Revolving Credit Agreement***

During the nine months ended September 30, 2007, we borrowed \$440.5 million under our Revolving Credit Agreement to fund a portion of our capital expenditures. Additionally, we repaid \$260.0 million during the nine months ended September 30, 2007. The Revolving Credit Agreement bears interest based on either an alternative base rate or LIBOR, which was 5.8% as of September 30, 2007. As of September 30, 2007, we had \$225.5 million available for borrowing under our Revolving Credit Agreement.

***Interest Rate Swaps***

As of September 30, 2007, the weighted-average interest rate for our interest rate swaps was 6.3%.

**5. COMMITMENTS AND CONTINGENCIES*****Litigation and Environmental Matters***

We have contingent liabilities resulting from various litigation, claims and commitments, the most significant of which are 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 September 30, 2007, we have accrued \$1.2 million related to settled matters and \$48.8 million related to contingent losses. The actual payment of any amounts accrued and the timing of such payments ultimately made is uncertain. We believe that should we be unable to successfully defend ourselves in any of these matters, the ultimate payment of any or all of the amounts accrued would not have a material adverse effect on our financial position or liquidity. However, if any actual losses ultimately exceed the amounts accrued, there could be a material adverse effect on our results of operations.

*Grace Energy Corporation Matter.* In 1997, Grace Energy Corporation (Grace Energy) sued subsidiaries of Kaneb Pipe Line Partners, L.P. (KPP) and Kaneb Services, LLC (KSL) and, collectively with KPP and their respective subsidiaries, Kaneb) in Texas state court. The complaint sought recovery of the cost of remediation of fuel leaks occurring during 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.

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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 trial court's final judgment 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. Once that stay is lifted, we intend to resume vigorous prosecution of the appeal.



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**Table of Contents**

**NUSTAR ENERGY L.P. AND SUBSIDIARIES**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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 Texas state court's final judgment assigning ownership of the Otis AFB pipeline to Kaneb, the U.S. Department of Justice advised Kaneb in 2001 that it intends to seek reimbursement from Kaneb for the remediation costs associated with the two spill areas. In 2002, the Department of Justice asserted that it had incurred over \$49.0 million in costs and expected to incur additional costs of approximately \$19.0 million for remediation of the two spill areas. The Department of Justice has not filed a lawsuit against us related to this matter, and we have not made any payments toward costs incurred by the Department of Justice.

*Port of Vancouver Matter.* We own a chemical and refined products terminal on property owned by the Port of Vancouver, and we lease the land under the terminal from the Port of Vancouver. Under an Agreed Order entered into with the Washington Department of Ecology when Kaneb purchased the terminal in 1998, Kaneb agreed to investigate and remediate groundwater contamination by the terminal's previous owner and operator originating from the terminal. Investigation and remediation at the terminal are ongoing, in compliance with the Agreed Order. In April 2006, the Washington Department of Ecology commented on our site investigation work plan and asserted that the groundwater contamination at the terminal was commingled with a groundwater contamination plume under other property owned by the Port of Vancouver. Since that time, we have negotiated with the Washington Department of Ecology, and on November 7, 2007, we entered into an Agreed Order that outlines a plan for site assessment, monitoring and interim action with regard to the plume for which Kaneb is responsible. The Agreed Order contains a diagram indicating that the plume for which Kaneb is responsible is separate from proximately located plumes.

*EPA Investigation.* On November 14, 2006, agents of the U.S. Environmental Protection Agency (the EPA) presented a search warrant issued by a U.S. District Court at one of our terminals. Since then, the U.S. District Court has also served us with four subpoenas. The search warrant and subpoenas all seek information regarding allegations of potential illegal conduct by us, certain of our subsidiaries and/or our employees concerning compliance with certain environmental and safety laws and regulations. We are cooperating fully with the EPA in producing documents in response to the subpoenas. We have no information as to when the EPA will conclude their investigation, and we are also conducting an internal investigation of any possible noncompliance. At this time, the EPA has not suggested any fines or penalties. There can be no assurances that the conclusion of the EPA's investigation will not result in a determination that we violated applicable laws. If we are found to have violated such laws, we could be subject to fines, civil penalties and criminal penalties. A final determination that we violated applicable laws could, among other things, result in our debarment from future federal government contracts. Because of the preliminary nature of the investigation, we are not able to estimate a loss or range of loss, if any. However, if any of the consequences described above ultimately occur, it is reasonably possible that the effects could be material to our results of operations in the period in which we would be required to record a liability, and could be material to our cash flows in the periods in which we would be required to pay such liability.

***Other***

We are also a party to additional claims and legal proceedings arising in the ordinary course of business. We believe the possibility is remote that the final outcome of any of these claims or proceedings to which we are a party would have a material adverse effect on our financial position, results of operations or liquidity; however, 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.

***Commitments***

In the first quarter of 2007, we entered into a three-year agreement to purchase a minimum of 4.5 million barrels of bunker fuel at market prices for resale to our customers. We estimated the value of this commitment to be approximately \$203.0 million, which will fluctuate with market prices.

The building lease for our new headquarters became effective in the first quarter of 2007. We have a minimum commitment of approximately \$13.5 million over almost 11 years.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****6. RELATED PARTY TRANSACTIONS**

Since we do not have any employees, we rely upon employees of NuStar GP, LLC. We reimburse NuStar GP, LLC for all employee-related costs. The amount of employee benefit plan expenses we reimbursed to NuStar GP, LLC, including compensation expense related to grants of our restricted common units and unit options, was \$9.5 million and \$8.9 million for the three months ended September 30, 2007 and 2006, respectively, and \$33.6 million and \$25.3 million for the nine months ended September 30, 2007 and 2006, respectively. These employee benefit plan expenses and the related payroll costs are included in operating expenses and general and administrative expenses. We had a receivable of \$1.1 million and a payable of \$2.3 million, as of September 30, 2007 and December 31, 2006, respectively, to NuStar GP, LLC, with both amounts representing payroll and plan benefits, net of payments made by us. We also had a long-term payable as of September 30, 2007 and December 31, 2006 of \$5.7 million to NuStar GP, LLC related to amounts payable for retiree medical benefits and other post-employment benefits.

For the three and nine months ended September 30, 2006, we have presented transactions with Valero Energy Corporation (Valero Energy) for pipeline tariff, terminalling fee and crude oil storage tank fee revenues, certain employee costs, insurance costs, administrative costs and lease expense in the consolidated statement of income as related party transactions. Under the terms of various services agreements with Valero Energy, we reimbursed Valero Energy for payroll costs of employees working on our behalf. Additionally, Valero Energy charged us an administrative service fee. Due to Valero Energy's sale of its interest in NuStar GP Holdings on December 22, 2006, we ceased reporting these transactions with Valero Energy as related party transactions subsequent to that date.

The following table summarizes information pertaining to related party transactions with NuStar GP, LLC for the three and nine months ended September 30, 2007 and with Valero Energy for the three and nine months ended September 30, 2006:

|                                     | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|-------------------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                                     | 2007                                | 2006      | 2007                               | 2006       |
|                                     | (Thousands of Dollars)              |           |                                    |            |
| Revenues                            | \$                                  | \$ 69,209 | \$                                 | \$ 194,298 |
| Operating expenses                  | 23,158                              | 24,749    | 66,875                             | 68,559     |
| General and administrative expenses | 8,299                               | 7,963     | 27,320                             | 20,767     |

**Services Agreement**

Prior to our separation from Valero Energy, the employees of NuStar GP, LLC were provided to us under the terms of various services agreements between us and Valero Energy. The terms of these services agreements generally provided that the costs of employees who performed services directly on our behalf, including salaries, wages and employee benefits, were charged directly to us. In addition, Valero Energy charged us an administrative services fee, which was \$0.3 million and \$1.3 million for the three and nine months ended September 30, 2006, respectively.

Although Valero Energy no longer provides employees that work directly on our behalf, Valero Energy continues to provide certain services to us under the terms of a services agreement dated December 22, 2006 (the 2007 Services Agreement). Beginning January 1, 2007, under the 2007 Services Agreement, we paid Valero Energy approximately \$97,000 per month for administrative services (primarily information system services and human resource services) and approximately \$93,000 per month for telecommunication services.

On April 16, 2007, Valero Energy exercised its option to terminate the 2007 Services Agreement. As a result, Valero Energy will cease providing services over a period of time sufficient to allow us to assume those functions. As of September 30, 2007, Valero Energy continues to provide certain human resource services, which are expected to terminate at the end of the year. Additionally, since Valero Energy elected to terminate the 2007 Services Agreement prior to December 31, 2010, they paid us a termination fee of \$13.0 million in May 2007.



**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. PARTNERS EQUITY***Allocation of Income and Income Per Unit*

Our partnership agreement, as amended, sets forth the calculation to be used to determine the amount and priority of cash distributions that the limited partners and the general partner will receive. The partnership agreement also contains provisions for the allocation of net income and loss to the limited partners and the general partner. For purposes of maintaining partner capital accounts, the partnership agreement specifies that items of income and loss shall be allocated among the partners in accordance with their respective percentage interests. Normal allocations according to percentage interests are done after giving effect, if any, to priority income allocations in an amount equal to incentive cash distributions allocated 100% to the general partner.

We identified our general partner interest as a participating security and we use the two-class method when calculating income per unit applicable to limited partners, which is based on the weighted-average number of common units outstanding during the period. Basic and diluted net income per unit applicable to limited partners is the same because we have no potentially dilutive securities outstanding.

The following table details the calculation of net income applicable to the general partner:

|  | Three Months Ended     |                       | Nine Months Ended     |                       |
|--|------------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2007  | September 30,<br>2006 | September 30,<br>2007 | September 30,<br>2006 |
|  | (Thousands of Dollars) |                       |                       |                       |
| Net income applicable to general partner and limited partners interest   | \$ 51,213              | \$ 41,169             | \$ 122,033            | \$ 112,173            |
| Charges reimbursed by the general partner  |                        | 352                   |                       | 352                   |
| Net income before charges reimbursed by the general partner  | 51,213                 | 41,521                | 122,033               | 112,525               |
| Less general partner incentive distribution  | 4,915                  | 3,909                 | 13,238                | 10,869                |
| Net income before charges reimbursed by general partner and after general partner incentive distribution                               | 46,298                 | 37,612                | 108,795               | 101,656               |
| General partner interest   | 2%                     | 2%                    | 2%                    | 2%                    |
| General partner allocation of net income before charges reimbursed by general partner and after general partner incentive distribution | 927                    | 753                   | 2,176                 | 2,033                 |
| Charges reimbursed by the general partner  |                        | (352)                 |                       | (352)                 |
| General partner incentive distribution   | 4,915                  | 3,909                 | 13,238                | 10,869                |
| Net income applicable to general partner   | \$ 5,842               | \$ 4,310              | \$ 15,414             | \$ 12,550             |

*Cash Distributions*

On July 26, 2007, we declared a quarterly cash distribution of \$0.950 per unit, which was paid on August 14, 2007 to unitholders of record on August 7, 2007, totaling \$49.9 million. On October 25, 2007, we declared a quarterly cash distribution of \$0.985 per unit to be paid on November 14, 2007 to unitholders of record on November 8, 2007, which will total \$52.1 million.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table reflects the allocation of total cash distributions to the general and limited partners applicable to the period in which the distributions were earned:

|  | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                   |
|--|-------------------------------------|------------------|------------------------------------|-------------------|
|  | 2007                                | 2006             | 2007                               | 2006              |
|  | (Thousands of Dollars)              |                  |                                    |                   |
| General partner interest                                   | \$ 1,041                            | \$ 955           | \$ 2,992                           | \$ 2,787          |
| General partner incentive distribution                     | 4,915                               | 3,909            | 13,238                             | 10,869            |
| <b>Total general partner distribution</b>                  | <b>5,956</b>                        | <b>4,864</b>     | <b>16,230</b>                      | <b>13,656</b>     |
| Limited partners distribution                              | 46,108                              | 42,830           | 133,408                            | 125,684           |
| <b>Total cash distributions</b>                            | <b>\$ 52,064</b>                    | <b>\$ 47,694</b> | <b>\$ 149,638</b>                  | <b>\$ 139,340</b> |
| Cash distributions per unit applicable to limited partners | \$ 0.985                            | \$ 0.915         | \$ 2.850                           | \$ 2.685          |

**Comprehensive Income**

The difference between our net income and our comprehensive income resulted from foreign currency translation adjustments. Our total comprehensive income was as follows:

|   | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                   |
|---|-------------------------------------|------------------|------------------------------------|-------------------|
|   | 2007                                | 2006             | 2007                               | 2006              |
|   | (Thousands of Dollars)              |                  |                                    |                   |
| Net income                              | \$ 51,213                           | \$ 41,169        | \$ 122,033                         | \$ 112,173        |
| Foreign currency translation adjustment | 9,361                               | (103)            | 20,723                             | 8,963             |
| <b>Comprehensive income</b>             | <b>\$ 60,574</b>                    | <b>\$ 41,066</b> | <b>\$ 142,756</b>                  | <b>\$ 121,136</b> |

**Shelf Registration**

On May 18, 2007, the SEC declared effective our shelf registration statement on Form S-3, which will permit us to offer and sell various types of securities, including NuStar Energy L.P. common units and debt securities of each NuStar Logistics and KPOP, having an aggregate value of up to \$3.0 billion.

**8. OTHER INCOME**

Other income consisted of the following:

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|  | Three Months Ended     |          | Nine Months Ended     |          |
|--|------------------------|----------|-----------------------|----------|
|  | September 30,<br>2007  | 2006     | September 30,<br>2007 | 2006     |
|  | (Thousands of Dollars) |          |                       |          |
| 2007 Services Agreement termination fee (see Note 6) | \$                     | \$       | \$ 13,000             | \$       |
| Business interruption insurance                      | 5,400                  |          | 12,492                |          |
| Sale of net profit interest in coal mine             | 7,250                  |          | 7,250                 |          |
| Legal settlements                                    |                        |          | 5,758                 |          |
| Foreign exchange (losses) gains                      | (2,653)                | 82       | (6,025)               | 56       |
| Other  | 4,669                  | 1,235    | 6,440                 | 1,220    |
| Other income, net                                    | \$ 14,666              | \$ 1,317 | \$ 38,915             | \$ 1,276 |

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. STATEMENTS OF CASH FLOWS**

Changes in current assets and current liabilities were as follows:

|  | <b>Nine Months Ended September 30,</b> |                 |
|--|--|-----------------|
|  | <b>2007</b>                            | <b>2006</b>     |
|  | <b>(Thousands of Dollars)</b>          |                 |
| Decrease (increase) in current assets:                               |  |                 |
| Receivable from related party  | \$                                     | \$ 741          |
| Accounts receivable  | (15,631)                               | 32,997          |
| Inventories  | (16,135)                               | 8,672           |
| Other current assets   | (4,097)                                | 1,335           |
| Increase (decrease) in current liabilities:                          |  |                 |
| Payable to related party   | (3,441)                                | (88)            |
| Accrued interest payable   | (6,252)                                | (6,652)         |
| Accounts payable, other accrued liabilities and income taxes payable | (200)                                  | (36,693)        |
| Taxes other than income taxes  | 2,660                                  | 3,205           |
| <b>Changes in current assets and current liabilities</b>             | <b>\$ (43,096)</b>                     | <b>\$ 3,517</b> |

Cash flows related to interest and income taxes were as follows:

|   | <b>Nine Months Ended September 30,</b> |             |
|---|--|-------------|
|   | <b>2007</b>                            | <b>2006</b> |
|   | <b>(Thousands of Dollars)</b>          |             |
| Cash paid for interest                                  | \$ 73,076                              | \$ 62,941   |
| Cash paid for income taxes, net of tax refunds received | \$ 6,889                               | \$ 5,952    |

Non-cash investing and financing activities for the nine months ended September 30, 2007 included:

adjustments to property and equipment, goodwill and intangible assets resulting from adjustments to the purchase price allocations related to the St. James crude oil storage facility acquisition.

acquisition of other current assets in exchange for a note payable.

Non-cash investing activities for the nine months ended September 30, 2006 included adjustments to property and equipment, goodwill and other balance sheet accounts resulting from adjustments to the purchase price allocations related to the 2005 acquisition of Kaneb Pipe Line Partners, L.P. and Kaneb Services, LLC.

**10. DERIVATIVES AND FINANCIAL INSTRUMENTS**

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We created a marketing and trading organization to capitalize on opportunities to optimize the use and profitability of our assets, to manage our risk as we diversify our business and to enhance our competitive position when pursuing acquisitions. We purchase heavy fuel oil, asphalt and refined products for resale to third parties. We manage our exposure to price risk associated with these inventories by entering into economic hedges. Additionally, we engage in a limited trading program. This marketing and trading organization is included in the other segment.

We utilize various derivative instruments to: (i) manage our exposure to commodity price risk, (ii) engage in a trading program and (iii) manage our exposure to interest rate risk. Our risk management policies and procedures are designed to monitor interest rates, NYMEX and over-the-counter positions, as well as physical volumes, grades, locations and delivery schedules to help ensure that our hedging activities address our market risks. We have a risk management group that has direct oversight responsibilities for our risk policies and our trading controls and procedures and certain aspects of risk management. Our risk management group also approves all new risk management strategies through a formal process.

The following sections discuss our risk management activities in the indicated categories.



**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Commodity Price-Risk Hedging***

We manage our exposure to price fluctuations with respect to our inventory of heavy fuels and refined products with economic hedges and forward sale contracts. The derivative instruments we use consist primarily of futures contracts and swaps traded on the NYMEX. Changes in the fair values of our economic hedges generally are offset, at least partially, by changes in the values of the hedged physical inventory. However, our economic hedges do not receive hedge accounting treatment under Statement of Financial Accounting Standards No. 133 (Statement No. 133). We record these derivative instruments in the consolidated balance sheet at fair value with mark-to-market adjustments recorded in cost of sales. Fair value is based on quoted market prices.

We have determined that substantially all of our physical purchase and sale agreements qualify for the normal purchase and sale exclusion and thus are not subject to Statement No. 133.

***Trading Program***

On a limited basis, we also enter into derivative commodity instruments based on our fundamental and technical analysis of market conditions in order to profit from market fluctuations. These derivative instruments are financial positions entered into without underlying physical inventory and are not considered economic hedges. We record these derivative instruments in the consolidated balance sheet at fair value, with mark-to-market adjustments recorded in revenues. Fair value is based on quoted market prices.

***Interest Rate Risk Hedging***

We entered into interest rate swap agreements for the purpose of hedging the interest rate risk associated with a portion of our fixed-rate senior notes. We account for the interest rate swaps as fair value hedges and recognize the fair value of each interest rate swap in the consolidated balance sheet as either an asset or liability. The interest rate swap contracts qualify for the shortcut method of accounting prescribed by Statement No. 133. As a result, changes in the fair value of the swaps completely offset the changes in the fair value of the underlying debt, and there is no earnings impact.

The earnings impact for our derivative activity was as follows:

|                              | <b>Three and Nine Months Ended<br/>September 30, 2007</b> |                |                   |
|------------------------------|---|----------------|-------------------|
|                              | <b>Mark-to-</b>   |                |                   |
|                              | <b>market, net</b>  | <b>Settled</b> | <b>Total</b>      |
|                              | <b>(Thousands of Dollars,</b>                             |                |                   |
|                              | <b>losses designated in brackets)</b>                     |                |                   |
| Commodity price-risk hedging | \$ (1,153)  | \$ 429         | \$ (724)          |
| Trading                      | (1,716)   | (191)          | (1,907)           |
| <b>Total</b>                 | <b>\$ (2,869)</b>   | <b>\$ 238</b>  | <b>\$ (2,631)</b> |

Prior to the third quarter of 2007, we had not entered into any derivatives with earnings impact.

The fair values of our derivative financial instruments are included in the Consolidated Balance Sheets as follows:

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|                             | September 30,<br>2007  | December 31,<br>2006 |
|-----------------------------|------------------------|----------------------|
|                             | (Thousands of Dollars) |                      |
| Accrued liabilities         | \$ (2,869)             | \$                   |
| Other long-term liabilities | (3,000)                | (4,908)              |
| <b>Total liability</b>      | <b>\$ (5,869)</b>      | <b>\$ (4,908)</b>    |

We are exposed to credit risk on our hedging instruments in the event of nonperformance by counterparties. However, because our hedging activities are transacted only with highly rated institutions, we do not anticipate nonperformance by any of these counterparties.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****11. SEGMENT INFORMATION**

Our operating segments consist of refined product terminals, refined product pipelines, crude oil pipelines, crude oil storage tanks and an other segment. These reportable segments are strategic business units that offer different services and performance is evaluated based on operating income, before general and administrative expenses. General and administrative expenses are not allocated to the operating segments since those expenses relate primarily to the overall management at the entity level. Our principal services include providing pipeline transportation services, terminalling services, storage lease services and crude oil storage handling services. Our product sales primarily consist of the sale of bunker fuel to marine vessels. Revenues included in the other segment, which began in the second quarter of 2007, relate to the resale of heavy fuel oil, asphalt and refined products purchased from third parties.

Results of operations for the reportable segments were as follows:

|  | Three Months Ended<br>September 30, |                   | Nine Months Ended<br>September 30, |                   |
|--|-------------------------------------|-------------------|------------------------------------|-------------------|
|  | 2007                                | 2006              | 2007                               | 2006              |
|  | (Thousands of Dollars)              |                   |                                    |                   |
| <b>Revenues:</b>                                 |                                     |                   |                                    |                   |
| Refined product terminals:                       |                                     |                   |                                    |                   |
| Third party revenues                             | \$ 256,362                          | \$ 204,567        | \$ 717,753                         | \$ 601,958        |
| Intersegment revenues                            | 878                                 |                   | 1,422                              |                   |
| <b>Total refined product terminals</b>           | <b>257,240</b>                      | <b>204,567</b>    | <b>719,175</b>                     | <b>601,958</b>    |
| Refined product pipelines:                       |                                     |                   |                                    |                   |
| Third party revenues                             | 69,031                              | 59,333            | 179,557                            | 163,580           |
| Intersegment revenues                            | 1,580                               |                   | 1,580                              |                   |
| <b>Total refined product pipelines</b>           | <b>70,611</b>                       | <b>59,333</b>     | <b>181,137</b>                     | <b>163,580</b>    |
| Crude oil pipelines                              | 15,612                              | 15,072            | 38,077                             | 43,989            |
| Crude oil storage tanks                          | 11,977                              | 12,051            | 34,379                             | 35,468            |
| Other  | 41,560                              |                   | 42,106                             |                   |
| <b>Total segment revenues</b>                    | <b>397,000</b>                      | <b>291,023</b>    | <b>1,014,874</b>                   | <b>844,995</b>    |
| Less consolidation and intersegment eliminations | 2,458                               |                   | 3,002                              |                   |
| <b>Total revenues</b>                            | <b>\$ 394,542</b>                   | <b>\$ 291,023</b> | <b>\$ 1,011,872</b>                | <b>\$ 844,995</b> |
| <b>Operating income (loss):</b>                  |                                     |                   |                                    |                   |
| Refined product terminals                        | \$ 32,604                           | \$ 26,602         | \$ 89,868                          | \$ 75,474         |
| Refined product pipelines                        | 29,144                              | 22,209            | 66,428                             | 62,176            |
| Crude oil pipelines                              | 9,588                               | 9,236             | 22,535                             | 27,634            |
| Crude oil storage tanks                          | 7,421                               | 7,721             | 20,252                             | 22,702            |
| Other  | (4,568)                             |                   | (5,410)                            |                   |
| <b>Total segment operating income</b>            | <b>74,189</b>                       | <b>65,768</b>     | <b>193,673</b>                     | <b>187,986</b>    |
| Less general and administrative expenses         | 16,118                              | 11,388            | 48,607                             | 30,323            |
| Less intersegment eliminations                   | 185                                 |                   | 185                                |                   |
| <b>Total operating income</b>                    | <b>\$ 57,886</b>                    | <b>\$ 54,380</b>  | <b>\$ 144,881</b>                  | <b>\$ 157,663</b> |



**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Total assets by reportable segment were as follows:

|  | <b>September 30,<br/>2007</b> | <b>December 31,<br/>2006</b> |
|--|-------------------------------|------------------------------|
|  | <b>(Thousands of Dollars)</b> |                              |
| Refined product terminals                                    | \$ 1,941,760                  | \$ 1,830,584                 |
| Refined product pipelines                                    | 1,246,700                     | 1,250,466                    |
| Crude oil pipelines  | 128,946                       | 132,407                      |
| Crude oil storage tanks                                      | 193,515                       | 197,902                      |
| Other segment  | 39,385                        |                              |
| <br>   |                               |                              |
| Total segment assets   | 3,550,306                     | 3,411,359                    |
| Other partnership assets assets and other noncurrent assets) | 102,299                       | 82,849                       |
| <br>   |                               |                              |
| Total consolidated assets                                    | \$ 3,652,605                  | \$ 3,494,208                 |

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. CONDENSED CONSOLIDATING FINANCIAL STATEMENTS**

NuStar Energy L.P. has no operations, and its assets consist mainly of its investments in NuStar Logistics and KPOP. NuStar Logistics and KPOP own and operate pipelines, terminals and storage tanks and are issuers of publicly traded senior notes. The senior notes issued by NuStar Logistics and KPOP are fully and unconditionally guaranteed by NuStar Energy L.P. In addition, both NuStar Logistics and KPOP fully and unconditionally guaranteed the outstanding senior notes of the other.

As a result, the following condensed consolidating financial statements are presented for 2007 and 2006 as an alternative to providing separate financial statements for NuStar Logistics and KPOP.

**Condensed Consolidating Balance Sheet****September 30, 2007****(Thousands of Dollars)**

|   | NuStar<br>Energy |                     | Non-<br>Guarantor<br>Subsidiaries<br>(a) |              | Eliminations   | Consolidated |
|---|------------------|---------------------|--|--------------|----------------|--------------|
|   | L.P.             | NuStar<br>Logistics | KPOP                                     |              |                |              |
| <b>Assets</b>                           |                  |                     |  |              |                |              |
| Current assets                          | \$ 155           | \$ 182,727          | \$ 666,198                               | \$ 380,281   | \$ (961,470)   | \$ 267,891   |
| Property and equipment, net             |                  | 930,405             | 666,794                                  | 842,770      |                | 2,439,969    |
| Intangible assets, net                  |                  | 3,758               |  | 45,684       |                | 49,442       |
| Goodwill                                |                  | 18,590              | 170,652                                  | 596,979      |                | 786,221      |
| Investment in wholly owned subsidiaries | 2,350,419        | 8,173               | 719,561                                  | 1,413,009    | (4,491,162)    |              |
| Investments in joint ventures           |                  | 16,470              |  | 62,033       |                | 78,503       |
| Deferred income tax asset               |                  |                     |  | 11,503       |                | 11,503       |
| Deferred charges and other assets, net  | 75               | 13,897              | 438                                      | 4,666        |                | 19,076       |
| Total assets                            | \$ 2,350,649     | \$ 1,174,020        | \$ 2,223,643                             | \$ 3,356,925 | \$ (5,452,632) | \$ 3,652,605 |
| <b>Liabilities and Partners Equity</b>  |                  |                     |  |              |                |              |
| Current liabilities                     | \$ 505,023       | \$ 41,308           | \$ 26,570                                | \$ 546,673   | \$ (961,285)   | \$ 158,289   |
| Long-term debt, less current portion    |                  | 930,014             | 540,626                                  | 42,857       |                | 1,513,497    |
| Long-term payable to related party      |                  |                     |  | 5,700        |                | 5,700        |
| Deferred income tax liability           |                  |                     |  | 36,330       |                | 36,330       |
| Other long-term liabilities             |                  | 7,013               | 1,755                                    | 56,853       |                | 65,621       |
| Partners equity                         | 1,845,626        | 195,685             | 1,654,692                                | 2,668,512    | (4,491,347)    | 1,873,168    |
| Total liabilities and partners equity   | \$ 2,350,649     | \$ 1,174,020        | \$ 2,223,643                             | \$ 3,356,925 | \$ (5,452,632) | \$ 3,652,605 |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Balance Sheet****December 31, 2006****(Thousands of Dollars)**

|  | NuStar<br>Energy    |                     |                     | Non-<br>Guarantor<br>Subsidiaries<br>(a) | Eliminations          | Consolidated        |
|--|---------------------|---------------------|---------------------|--|-----------------------|---------------------|
|  | L.P.                | NuStar<br>Logistics | KPOP                |  |                       |                     |
| <b>Assets</b>                                |                     |                     |                     |  |                       |                     |
| Current assets                               | \$ 403              | \$ 115,210          | \$ 653,221          | \$ 145,807                               | \$ (701,643)          | \$ 212,998          |
| Property and equipment, net                  |                     | 935,109             | 676,494             | 733,532                                  |                       | 2,345,135           |
| Intangible assets, net                       |                     | 3,427               |                     | 50,105                                   |                       | 53,532              |
| Goodwill                                     |                     | 4,715               | 172,116             | 597,610                                  |                       | 774,441             |
| Investment in wholly owned subsidiaries      | 2,372,469           | 24,172              | 668,796             | 1,345,791                                | (4,411,228)           |                     |
| Investments in joint ventures                |                     | 15,902              |                     | 58,175                                   |                       | 74,077              |
| Deferred income tax liability                |                     |                     |                     | 11,342                                   |                       | 11,342              |
| Deferred charges and other assets, net       | 228                 | 5,807               | 604                 | 16,044                                   |                       | 22,683              |
| <b>Total assets</b>                          | <b>\$ 2,373,100</b> | <b>\$ 1,104,342</b> | <b>\$ 2,171,231</b> | <b>\$ 2,958,406</b>                      | <b>\$ (5,112,871)</b> | <b>\$ 3,494,208</b> |
| <b>Liabilities and Partners Equity</b>       |                     |                     |                     |  |                       |                     |
| Current liabilities                          | \$ 504,238          | \$ 44,397           | \$ 29,385           | \$ 280,358                               | \$ (701,643)          | \$ 156,735          |
| Long-term debt, less current portion         |                     | 767,031             | 545,571             | 41,118                                   |                       | 1,353,720           |
| Long-term payable to related party           |                     |                     |                     | 5,749                                    |                       | 5,749               |
| Deferred income tax liability                |                     |                     |                     | 32,926                                   |                       | 32,926              |
| Other long-term liabilities                  |                     | 5,797               | 3,517               | 60,083                                   |                       | 69,397              |
| Partners equity                              | 1,868,862           | 287,117             | 1,592,758           | 2,538,172                                | (4,411,228)           | 1,875,681           |
| <b>Total liabilities and partners equity</b> | <b>\$ 2,373,100</b> | <b>\$ 1,104,342</b> | <b>\$ 2,171,231</b> | <b>\$ 2,958,406</b>                      | <b>\$ (5,112,871)</b> | <b>\$ 3,494,208</b> |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statements of Income****For the Three Months Ended September 30, 2007****(Thousands of Dollars)**

|                                     |                          |                     | Non-      |                                  |              |              |
|-------------------------------------|--------------------------|---------------------|-----------|----------------------------------|--------------|--------------|
|                                     | NuStar<br>Energy<br>L.P. | NuStar<br>Logistics | KPOP      | Guarantor<br>Subsidiaries<br>(a) | Eliminations | Consolidated |
| Revenues                            | \$                       | \$ 79,072           | \$ 38,341 | \$ 279,586                       | \$ (2,457)   | \$ 394,542   |
| Costs and expenses                  | 833                      | 42,849              | 28,750    | 266,496                          | (2,272)      | 336,656      |
| Operating income                    | (833)                    | 36,223              | 9,591     | 13,090                           | (185)        | 57,886       |
| Equity earnings in subsidiaries     | 52,046                   | (4,578)             | 16,547    | 20,024                           | (84,039)     |              |
| Equity earnings from joint ventures |                          | 14                  |           | 1,599                            |              | 1,613        |
| Interest expense, net               |                          | (13,569)            | (6,199)   | 387                              |              | (19,381)     |
| Other income, net                   |                          | 6,742               | 82        | 7,842                            |              | 14,666       |
| Income before income tax expense    | 51,213                   | 24,832              | 20,021    | 42,942                           | (84,224)     | 54,784       |
| Income tax expense                  |                          | 361                 |           | 3,210                            |              | 3,571        |
| Net income                          | \$ 51,213                | \$ 24,471           | \$ 20,021 | \$ 39,732                        | \$ (84,224)  | \$ 51,213    |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.



**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statements of Income****For the Three Months Ended September 30, 2006****(Thousands of Dollars)**

|                                     | NuStar<br>Energy<br>L.P. | NuStar<br>Logistics | KPOP      | Non-<br>Guarantor<br>Subsidiaries<br>(a) | Eliminations | Consolidated |
|-------------------------------------|--------------------------|---------------------|-----------|--|--------------|--------------|
| Revenues                            | \$                       | \$ 68,713           | \$ 31,013 | \$ 191,550                               | \$ (253)     | \$ 291,023   |
| Costs and expenses                  | 730                      | 36,563              | 26,363    | 173,240                                  | (253)        | 236,643      |
| Operating income                    | (730)                    | 32,150              | 4,650     | 18,310                                   |              | 54,380       |
| Equity earnings in subsidiaries     | 41,899                   | (19)                | 19,923    | 19,857                                   | (81,660)     |              |
| Equity earnings from joint ventures |                          | 404                 |           | 1,060                                    |              | 1,464        |
| Interest expense, net               |                          | (9,703)             | (4,684)   | (2,219)                                  |              | (16,606)     |
| Other income (expense), net         |                          | (6)                 | (34)      | 1,357                                    |              | 1,317        |
| Income before income tax expense    | 41,169                   | 22,826              | 19,855    | 38,365                                   | (81,660)     | 40,555       |
| Income tax benefit                  |                          |                     |           | (614)                                    |              | (614)        |
| Net income                          | \$ 41,169                | \$ 22,826           | \$ 19,855 | \$ 38,979                                | \$ (81,660)  | \$ 41,169    |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statements of Income****For the Nine Months Ended September 30, 2007****(Thousands of Dollars)**

|                                     | NuStar<br>Energy<br>L.P. | NuStar<br>Logistics | KPOP       | Non-<br>Guarantor<br>Subsidiaries<br>(a) | Eliminations | Consolidated |
|-------------------------------------|--------------------------|---------------------|------------|--|--------------|--------------|
| Revenues                            | \$                       | \$ 199,390          | \$ 106,573 | \$ 708,910                               | \$ (3,001)   | \$ 1,011,872 |
| Costs and expenses                  | 1,186                    | 127,188             | 76,528     | 664,905                                  | (2,816)      | 866,991      |
| Operating income                    | (1,186)                  | 72,202              | 30,045     | 44,005                                   | (185)        | 144,881      |
| Equity earnings in subsidiaries     | 123,219                  | (6,048)             | 50,766     | 61,939                                   | (229,876)    |              |
| Equity earnings from joint ventures |                          | 568                 |            | 4,402                                    |              | 4,970        |
| Interest expense, net               |                          | (39,439)            | (19,014)   | 766                                      |              | (57,687)     |
| Other income, net                   |                          | 27,392              | 136        | 11,387                                   |              | 38,915       |
| Income before income tax expense    | 122,033                  | 54,675              | 61,933     | 122,499                                  | (230,061)    | 131,079      |
| Income tax expense                  |                          | 922                 |            | 8,124                                    |              | 9,046        |
| Net income                          | \$ 122,033               | \$ 53,753           | \$ 61,933  | \$ 114,375                               | \$ (230,061) | \$ 122,033   |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statements of Income****For the Nine Months Ended September 30, 2006****(Thousands of Dollars)**

|   | NuStar<br>Energy<br>L.P. | NuStar<br>Logistics | KPOP      | Non-<br>Guarantor<br>Subsidiaries<br>(a) | Eliminations | Consolidated |
|---|--------------------------|---------------------|-----------|--|--------------|--------------|
| Revenues  | \$                       | \$ 194,091          | \$ 85,121 | \$ 566,522                               | \$ (739)     | \$ 844,995   |
| Costs and expenses  | 1,735                    | 104,528             | 68,795    | 513,013                                  | (739)        | 687,332      |
| Operating income  | (1,735)                  | 89,563              | 16,326    | 53,509                                   |              | 157,663      |
| Equity earnings in subsidiaries                               | 113,908                  | 216                 | 53,160    | 51,057                                   | (218,341)    |              |
| Equity earnings from joint ventures                           |                          | 549                 |           | 3,965                                    |              | 4,514        |
| Interest expense, net   |                          | (26,545)            | (18,719)  | (3,642)                                  |              | (48,906)     |
| Other income (expense), net                                   |                          | 41                  | (32)      | 1,267                                    |              | 1,276        |
| Income from continuing operations before income tax expense   | 112,173                  | 63,824              | 50,735    | 106,156                                  | (218,341)    | 114,547      |
| Income tax expense  |                          |                     |           | 1,997                                    |              | 1,997        |
| Income from continuing operations                             | 112,173                  | 63,824              | 50,735    | 104,159                                  | (218,341)    | 112,550      |
| Income (loss) from discontinued operations, net of income tax |                          |                     | 317       | (694)                                    |              | (377)        |
| Net income  | \$ 112,173               | \$ 63,824           | \$ 51,052 | \$ 103,465                               | \$ (218,341) | \$ 112,173   |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.

**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Cash Flows****For the Nine Months Ended September 30, 2007****(Thousands of Dollars)**

|   | <b>NuStar<br/>Energy<br/>L.P.</b> | <b>NuStar<br/>Logistics</b> | <b>KPOP</b> | <b>Non-Guarantor<br/>Subsidiaries<br/>(a)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------------|-----------------------------|-------------|---|---------------------|---------------------|
| <b>Cash flows from operating activities:</b>                                      |                                   |                             |             |   |                     |                     |
| Net income  | \$ 122,033                        | \$ 53,753                   | \$ 61,933   | \$ 114,375                                    | \$ (230,061)        | \$ 122,033          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |                             |             |   |                     |                     |
| Depreciation and amortization expense   |                                   | 34,793                      | 18,788      | 31,155  |                     | 84,736              |
| Equity earnings, net of distributions   | 22,050                            | 5,480                       | (50,766)    | (65,782)                                      | 84,592              | (4,426)             |
| Changes in current assets and liabilities and other                               | (353)                             | (3,078)                     | (9,634)     | (42,621)                                      | 185                 | (55,501)            |
| Net cash provided by (used in) operating activities                               | 143,730                           | 90,948                      | 20,321      | 37,127  | (145,284)           | 146,842             |
| <b>Cash flows from investing activities:</b>                                      |                                   |                             |             |   |                     |                     |
| Capital expenditures  |                                   | (42,435)                    | (9,068)     | (118,927)                                     |                     | (170,430)           |
| Proceeds from sale of assets  |                                   | 67                          | 12          | 4,705   |                     | 4,784               |
| Investment in other noncurrent assets   |                                   | (58)                        |             | (4)   |                     | (62)                |
| Proceeds from sale of net profit interest in coal mine                            |                                   |                             |             | 7,250   |                     | 7,250               |
| Other   |                                   | 23                          |             | 250   |                     | 273                 |
| Net cash used in investing activities   |                                   | (42,403)                    | (9,056)     | (106,726)                                     |                     | (158,185)           |
| <b>Cash flows from financing activities:</b>                                      |                                   |                             |             |   |                     |                     |
| Distributions to unitholders and general partner                                  | (145,269)                         | (145,269)                   |             | (15)  | 145,284             | (145,269)           |
| Repayments of notes payable   |                                   | (6,106)                     |             |   |                     | (6,106)             |
| Proceeds from long-term debt borrowings   |                                   | 440,515                     |             |   |                     | 440,515             |
| Long-term debt repayments   |                                   | (280,067)                   |             |   |                     | (280,067)           |
| Net intercompany borrowings (repayments)  | 1,539                             | (72,450)                    | (10,751)    | 81,662  |                     |                     |
| Other   |                                   | 4,105                       |             | 1,547   |                     | 5,652               |
| Net cash provided by (used in) financing activities                               | (143,730)                         | (59,272)                    | (10,751)    | 83,194  | 145,284             | 14,725              |
| Effect of foreign exchange rate changes on cash                                   |                                   | 486                         |             | 3,665   |                     | 4,151               |
| Net increase (decrease) in cash and cash equivalents                              |                                   | (10,241)                    | 514         | 17,260  |                     | 7,533               |
| Cash and cash equivalents at the beginning of the period                          | 137                               | 12,345                      | 992         | 55,364  |                     | 68,838              |
| Cash and cash equivalents at the end of the period                                | \$ 137                            | \$ 2,104                    | \$ 1,506    | \$ 72,624                                     | \$                  | \$ 76,371           |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.



**Table of Contents****NUSTAR ENERGY L.P. AND SUBSIDIARIES****CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Condensed Consolidating Statement of Cash Flows****For the Nine Months Ended September 30, 2006****(Thousands of Dollars)**

|   | <b>NuStar<br/>Energy<br/>L.P.</b> | <b>NuStar<br/>Logistics</b> | <b>KPOP</b>     | <b>Non-Guarantor<br/>Subsidiaries<br/>(a)</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|---|-----------------------------------|-----------------------------|-----------------|---|---------------------|---------------------|
| <b>Cash flows from operating activities:</b>                                      |                                   |                             |                 |   |                     |                     |
| Net income  | \$ 112,173                        | \$ 63,824                   | \$ 51,052       | \$ 103,465                                    | \$ (218,341)        | \$ 112,173          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |                             |                 |   |                     |                     |
| Depreciation and amortization expense   |                                   | 28,023                      | 18,326          | 27,673  |                     | 74,022              |
| Equity earnings, net of distributions   | 21,688                            | (765)                       | (53,160)        | (51,044)                                      | 82,732              | (549)               |
| Changes in operating assets and liabilities and other                             | (2,480)                           | (6,648)                     | (8,843)         | 14,304  |                     | (3,667)             |
| <b>Net cash provided by (used in) operating activities</b>                        | <b>131,381</b>                    | <b>84,434</b>               | <b>7,375</b>    | <b>94,398</b>                                 | <b>(135,609)</b>    | <b>181,979</b>      |
| <b>Cash flows from investing activities:</b>                                      |                                   |                             |                 |   |                     |                     |
| Capital expenditures  |                                   | (26,104)                    | (6,530)         | (37,681)                                      |                     | (70,315)            |
| Proceeds from sale of assets  |                                   | 8                           | 58              | 70,126  |                     | 70,192              |
| Acquisition and investment in noncurrent assets                                   |                                   | (14,423)                    | (50)            | (7,758)                                       |                     | (22,231)            |
| Other   | (77)                              | (6,259)                     | 26,604          | (21,658)                                      | 6,435               | 5,045               |
| <b>Net cash provided by (used in) investing activities</b>                        | <b>(77)</b>                       | <b>(46,778)</b>             | <b>20,082</b>   | <b>3,029</b>                                  | <b>6,435</b>        | <b>(17,309)</b>     |
| <b>Cash flows from financing activities:</b>                                      |                                   |                             |                 |   |                     |                     |
| Distributions to unitholders and general partner                                  | (135,596)                         | (135,596)                   |                 | (13)  | 135,609             | (135,596)           |
| Proceeds from long-term debt borrowings   |                                   | 59,000                      |                 |   |                     | 59,000              |
| Long-term debt repayments   |                                   | (48,480)                    |                 |   |                     | (48,480)            |
| Net intercompany borrowings (repayments)  | 4,074                             | 107,954                     | (26,879)        | (85,149)                                      |                     |                     |
| Other   | 352                               | (7,054)                     |                 | 4,878   | (6,435)             | (8,259)             |
| <b>Net cash provided by (used in) financing activities</b>                        | <b>(131,170)</b>                  | <b>(24,176)</b>             | <b>(26,879)</b> | <b>(80,284)</b>                               | <b>129,174</b>      | <b>(133,335)</b>    |
| <b>Effect of foreign exchange rate changes on cash</b>                            |                                   |                             |                 |   |                     |                     |
|   |                                   |                             |                 | (660)   |                     | (660)               |
| <b>Net increase in cash and cash equivalents</b>                                  | <b>134</b>                        | <b>13,480</b>               | <b>578</b>      | <b>16,483</b>                                 |                     | <b>30,675</b>       |
| <b>Cash and cash equivalents at the beginning of the period</b>                   | <b>10</b>                         | <b>1,590</b>                | <b>114</b>      | <b>34,340</b>                                 |                     | <b>36,054</b>       |
| <b>Cash and cash equivalents at the end of the period</b>                         | <b>\$ 144</b>                     | <b>\$ 15,070</b>            | <b>\$ 692</b>   | <b>\$ 50,823</b>                              | <b>\$</b>           | <b>\$ 66,729</b>    |

(a) Non-guarantor subsidiaries are wholly owned by NuStar Energy L.P., NuStar Logistics or KPOP.



**Table of Contents**

**NUSTAR ENERGY L.P. AND SUBSIDIARIES**

**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**13. SUBSEQUENT EVENT**

On November 6, 2007, we entered into a definitive agreement to acquire CITGO Asphalt Refining Company's asphalt operations and assets for \$450 million, plus an estimated \$100 million for working capital. The purchased assets include a 74,000 barrels-per-day (BPD) asphalt refinery in Paulsboro, New Jersey, a 30,000 BPD asphalt refinery in Savannah, Georgia and three asphalt terminals on the East coast with a combined storage capacity of 4.8 million barrels.



**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**FORWARD-LOOKING STATEMENTS**

*This Form 10-Q contains certain estimates, predictions, projections, assumptions and other forward-looking statements that involve various risks and uncertainties. While these forward-looking statements, and any assumptions upon which they are based, are made in good faith and reflect our current judgment regarding the direction of our business, actual results will almost always vary, sometimes materially, from any estimates, predictions, projections, assumptions or other future performance suggested in this report. These forward-looking statements can generally be identified by the words anticipates, believes, expects, plans, intends, estimates, forecasts, budgets, projects, will, could, should, may and similar expressions. These statements reflect our current views with regard to future events and are subject to various risks, uncertainties and assumptions. Please read our Annual Report on Form 10-K for the year ended December 31, 2006, Part I, Item 1A Risk Factors, as well as our subsequent quarterly reports on Form 10-Q, Part II, Item 1A Risk Factors, for a discussion of certain of those risks, uncertainties and assumptions.*

*If one or more of these risks or uncertainties materialize, or if the underlying assumptions prove incorrect, our actual results may vary materially from those described in any forward-looking statement. Other unknown or unpredictable factors could also have material adverse effects on our future results. Readers are cautioned not to place undue reliance on this forward-looking information, which is as of the date of the Form 10-Q. We do not intend to update these statements unless it is required by the securities laws to do so, and we undertake no obligation to publicly release the result of any revisions to any such forward-looking statements that may be made to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.*

**Overview**

NuStar Energy L.P. is a publicly traded Delaware limited partnership primarily engaged in the crude oil and refined product transportation, terminalling and storage business. NuStar Energy L.P. has terminal facilities in 28 U.S. states, the Netherlands Antilles, Canada, Mexico, the Netherlands and the United Kingdom.

As used in this report, references to we, us, our or the Partnership collectively refer, depending on the context, to NuStar Energy L.P. or a wholly owned subsidiary of NuStar Energy L.P.

We conduct our operations through our wholly owned subsidiaries, primarily NuStar Logistics, L.P. (NuStar Logistics) and Kaneb Pipe Line Operating Partnership, L.P. (KPOP). Our operations are divided into five reportable business segments: refined product terminals, refined product pipelines, crude oil pipelines, crude oil storage tanks and an other segment.

*Refined Product Terminals.* We own 54 terminals in the United States that provide storage and handling services on a fee basis for petroleum products, specialty chemicals and other liquids, including crude oil and other feedstocks. We also own international terminal operations on the island of St. Eustatius in the Caribbean and in Point Tupper in Nova Scotia, Canada, the United Kingdom, the Netherlands and in Nuevo Laredo, Mexico.

*Refined Product Pipelines.* We own common carrier pipelines in Texas, Oklahoma, Colorado, New Mexico, Kansas, Nebraska, Iowa, South Dakota, North Dakota and Minnesota covering approximately 6,259 miles. The Central West System is connected to Valero Energy Corporation (Valero Energy) refineries in Texas and Oklahoma, the North Pipeline is connected to Tesoro's Mandan refinery in North Dakota, and the East Pipeline is connected to various refineries in the midwest. In addition, we own a 2,000 mile anhydrous ammonia pipeline located in Louisiana, Arkansas, Missouri, Illinois, Indiana, Iowa and Nebraska.

*Crude Oil Pipelines.* We own 797 miles of crude oil pipelines which transport crude oil and other feedstocks, such as gas oil, from various points in Texas, Oklahoma, Kansas and Colorado to Valero Energy's McKee, Three Rivers and Ardmore refineries as well as associated crude oil storage facilities in Texas and Oklahoma that are located along the crude oil pipelines. We also own 57 miles of crude oil pipeline in Illinois, which serves ConocoPhillips' Wood River refinery.

**Table of Contents**

*Crude Oil Storage Tanks.* We own 60 crude oil and intermediate feedstock storage tanks and related assets that store and deliver crude oil and intermediate feedstock to Valero Energy's refineries in Benicia, California, Corpus Christi, Texas, Texas City, Texas and Three Rivers, Texas.

*Other.* The other segment consists of our product marketing and trading organization, which we created to capitalize on opportunities to optimize the use and profitability of our assets, to manage our risk as we diversify our business and to enhance our competitive position when pursuing acquisitions. Revenues included in the other segment, which began in the second quarter of 2007, relate to the purchase of heavy fuel oil, asphalt and refined products for resale to third parties. Also included in revenues are the mark-to-market results of our limited trading program.

We provide transportation, storage services and ancillary services to our customers. The following factors affect the results of our operations:

company-specific factors, such as integrity issues and maintenance requirements that impact the throughput rates of our assets;

seasonal factors that affect the demand for refined products and fertilizers transported by and/or stored in our assets;

industry factors, such as changes in the prices of petroleum products that affect demand and operations of our competitors;

factors such as seasonal inventory levels, commodity price volatility and market structure that impact our marketing and trading organization; and

other factors such as refinery utilization rates and maintenance turnaround schedules that impact the operations of refineries served by our assets.

***Recent Development***

On November 6, 2007, we entered into a definitive agreement to acquire CITGO Asphalt Refining Company's asphalt operations and assets for \$450 million, plus an estimated \$100 million for working capital. The purchased assets include a 74,000 barrels-per-day (BPD) asphalt refinery in Paulsboro, New Jersey, a 30,000 BPD asphalt refinery in Savannah, Georgia and three asphalt terminals on the East coast with a combined storage capacity of 4.8 million barrels.

**Table of Contents****Results of Operations***Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006***Financial Highlights**

(Unaudited, Thousands of Dollars, Except Unit and Per Unit Data)

|   | Three Months Ended<br>September 30, |                   |                 |
|---|-------------------------------------|-------------------|-----------------|
|   | 2007                                | 2006              | Change          |
| <b>Statement of Income Data:</b>                          |                                     |                   |                 |
| <b>Revenues:</b>  |                                     |                   |                 |
| Services revenues   | \$ 185,979                          | \$ 161,888        | \$ 24,091       |
| Product sales   | 208,563                             | 129,135           | 79,428          |
| <b>Total revenues</b>                                     | <b>394,542</b>                      | <b>291,023</b>    | <b>103,519</b>  |
| <b>Costs and expenses:</b>                                |                                     |                   |                 |
| Cost of product sales                                     | 199,023                             | 117,759           | 81,264          |
| Operating expenses  | 91,981                              | 82,502            | 9,479           |
| General and administrative expenses                       | 16,118                              | 11,388            | 4,730           |
| Depreciation and amortization expense                     | 29,534                              | 24,994            | 4,540           |
| <b>Total costs and expenses</b>                           | <b>336,656</b>                      | <b>236,643</b>    | <b>100,013</b>  |
| <b>Operating income</b>                                   | <b>57,886</b>                       | <b>54,380</b>     | <b>3,506</b>    |
| Equity earnings from joint ventures                       | 1,613                               | 1,464             | 149             |
| Interest expense, net                                     | (19,381)                            | (16,606)          | (2,775)         |
| Other income, net   | 14,666                              | 1,317             | 13,349          |
| <b>Income before income tax expense (benefit)</b>         | <b>54,784</b>                       | <b>40,555</b>     | <b>14,229</b>   |
| Income tax expense (benefit)                              | 3,571                               | (614)             | 4,185           |
| <b>Net income</b>   | <b>51,213</b>                       | <b>41,169</b>     | <b>10,044</b>   |
| Less net income applicable to general partner             | (5,842)                             | (4,310)           | (1,532)         |
| <b>Net income applicable to limited partners</b>          | <b>\$ 45,371</b>                    | <b>\$ 36,859</b>  | <b>\$ 8,512</b> |
| <b>Weighted-average number of basic units outstanding</b> | <b>46,809,749</b>                   | <b>46,809,749</b> |                 |
| <b>Net income per unit applicable to limited partners</b> | <b>\$ 0.97</b>                      | <b>\$ 0.79</b>    | <b>\$ 0.18</b>  |

**Table of Contents****Segment Operating Highlights**

(Thousands of Dollars, Except Barrels/Day Information)

|                                       | <b>Three Months Ended<br/>September 30,</b> |             |               |
|---------------------------------------|---|-------------|---------------|
|                                       | <b>2007</b>                                 | <b>2006</b> | <b>Change</b> |
| <b>Refined Product Terminals:</b>     |   |             |               |
| Throughput (barrels/day)              | 267,546                                     | 267,144     | 402           |
| Throughput revenues                   | \$ 14,092                                   | \$ 13,273   | \$ 819        |
| Storage lease revenues                | 76,888                                      | 62,925      | 13,963        |
| Product sales (bunkering)             | 166,260                                     | 128,369     | 37,891        |
| Total revenues                        | 257,240                                     | 204,567     | 52,673        |
| Cost of product sales                 | 154,828                                     | 117,161     | 37,667        |
| Operating expenses                    | 55,828                                      | 49,555      | 6,273         |
| Depreciation and amortization expense | 13,980                                      | 11,249      | 2,731         |
| Segment operating income              | \$ 32,604                                   | \$ 26,602   | \$ 6,002      |
| <b>Refined Product Pipelines:</b>     |   |             |               |
| Throughput (barrels/day)              | 719,385                                     | 722,952     | (3,567)       |
| Throughput revenues                   | \$ 68,288                                   | \$ 58,567   | \$ 9,721      |
| Product sales                         | 2,323                                       | 766         | 1,557         |
| Total revenues                        | 70,611                                      | 59,333      | 11,278        |
| Cost of product sales                 | 1,989                                       | 598         | 1,391         |
| Operating expenses                    | 27,862                                      | 25,972      | 1,890         |
| Depreciation and amortization expense | 11,616                                      | 10,554      | 1,062         |
| Segment operating income              | \$ 29,144                                   | \$ 22,209   | \$ 6,935      |
| <b>Crude Oil Pipelines:</b>           |   |             |               |
| Throughput (barrels/day)              | 410,758                                     | 410,211     | 547           |
| Throughput revenues                   | \$ 15,612                                   | \$ 15,072   | \$ 540        |
| Operating expenses                    | 4,815                                       | 4,559       | 256           |
| Depreciation and amortization expense | 1,209                                       | 1,277       | (68)          |
| Segment operating income              | \$ 9,588                                    | \$ 9,236    | \$ 352        |
| <b>Crude Oil Storage Tanks:</b>       |   |             |               |
| Throughput (barrels/day)              | 576,965                                     | 513,904     | 63,061        |
| Throughput revenues                   | \$ 11,977                                   | \$ 12,051   | \$ (74)       |
| Operating expenses                    | 2,650                                       | 2,416       | 234           |
| Depreciation and amortization expense | 1,906                                       | 1,914       | (8)           |
| Segment operating income              | \$ 7,421                                    | \$ 7,721    | \$ (300)      |
| <b>Other:</b>                         |   |             |               |
| Product sales                         | \$ 41,560                                   |             | \$ 41,560     |
| Cost of product sales                 | 43,796                                      |             | 43,796        |
| Operating expenses                    | 1,509                                       |             | 1,509         |
| Depreciation and amortization expense | 823   |             | 823           |

|                          |            |            |
|--------------------------|------------|------------|
| Segment operating income | \$ (4,568) | \$ (4,568) |
|--------------------------|------------|------------|

**Table of Contents****Segment Operating Highlights (Continued)**

(Thousands of Dollars, Except Barrels/Day Information)

|   | Three Months Ended<br>September 30, |            | Change     |
|---|-------------------------------------|------------|------------|
|   | 2007                                | 2006       |            |
| <b>Consolidation and Intersegment Eliminations:</b> |                                     |            |            |
| Throughput and storage lease revenues               | \$ (878)                            | \$         | \$ (878)   |
| Product sales                                       | (1,580)                             |            | (1,580)    |
| Total revenues                                      | (2,458)                             |            | (2,458)    |
| Cost of product sales                               | (1,590)                             |            | (1,590)    |
| Operating expenses                                  | (683)                               |            | (683)      |
| Total   | \$ (185)                            | \$         | \$ (185)   |
| <b>Consolidated Information:</b>                    |                                     |            |            |
| Revenues  | \$ 394,542                          | \$ 291,023 | \$ 103,519 |
| Cost of product sales                               | 199,023                             | 117,759    | 81,264     |
| Operating expenses                                  | 91,981                              | 82,502     | 9,479      |
| Depreciation and amortization expense               | 29,534                              | 24,994     | 4,540      |
| Segment operating income                            | 74,004                              | 65,768     | 8,236      |
| General and administrative expenses                 | 16,118                              | 11,388     | 4,730      |
| Consolidated operating income                       | \$ 57,886                           | \$ 54,380  | \$ 3,506   |

**Highlights**

Net income increased \$10.0 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, due to higher segmental operating income and an increase in other income, partially offset by increased general and administrative expense, interest expense and income tax expense.

Total segment operating income increased \$8.2 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to a \$6.9 million increase in operating income for the refined product pipelines segment, a \$6.0 million increase in operating income for the refined product terminals segment, partially offset by \$4.6 million decrease in operating income for the other segment.

The throughputs on the refined product pipelines, the refined product terminals and the crude oil pipelines segments were affected by a fire at Valero Energy's McKee refinery in February 2007, which shut down the refinery through mid-April. After the refinery restarted in mid-April, its throughputs increased throughout the second quarter and was near capacity by July 2007.

**Refined Product Terminals**

Revenues increased by \$52.7 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to an increase in product sales of \$37.9 million relating to bunker fuel due to both increased vessel calls and an increase in the market price per metric ton at our St. Eustatius facility. Storage lease revenues increased \$14.0 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, due to the following:

an increase of \$5.4 million resulting from the St. James terminal acquisition which occurred in December 2006;

an increase in storage lease terminal revenues of \$7.2 million primarily due to additional customers, contract extensions by current customers, higher reimbursable project revenue and the effect of foreign exchange rates; and

an increase in revenues of \$1.4 million at our St. Eustatius facility due to leasing additional storage capacity that resulted from completed tank expansion projects.

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## **Table of Contents**

Cost of product sales increased \$37.7 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, consistent with the increase in product sales revenues. Cost of product sales reflects the cost of bunker fuel sold to marine vessels at our St. Eustatius facility in the Caribbean.

Operating expenses increased \$6.3 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to higher reimbursable project expenses and higher operating expenses at our St. Eustatius facility resulting from increased vessel calls. Reimbursable project expenses are charged back to our customers, and its increase is consistent with the increase in reimbursable project revenues. Operating expenses also increased due to the acquisition of the St. James terminal in December 2006 and increased additive usage at several of our domestic terminals.

Depreciation and amortization expense increased \$2.7 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to the acquisition of the St. James terminal in December 2006 and the completion of various capital projects, including the first phase of the St. Eustatius tank expansion in the second quarter of 2007.

### ***Refined Product Pipelines***

Throughputs decreased 3,567 barrels per day for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to the impact of the McKee refinery fire, offset by increased throughputs on the East, Ammonia and Burgos pipelines. Despite lower overall throughputs, revenues increased by \$11.3 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to:

higher tariff rates on virtually all of the refined product pipelines as the annual index adjustment was effective July 1, 2007;

increased revenues and throughputs on the East and Ammonia pipelines due to a record corn crop, increased product sales and other favorable market conditions; and

increased revenues on the Burgos pipeline due to our receipt of an annual throughput deficiency payment in September 2007. In addition, revenues increased due to a full quarter of operations in the third quarter of 2007 as the Burgos pipeline commenced operations in the middle of the third quarter of 2006.

Cost of product sales increased \$1.4 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, consistent with the increase in product sales revenues.

Operating expenses increased \$1.9 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to higher maintenance and environmental costs, partially offset by decreased property taxes on several of the pipeline segments due to changes in property appraisals.

Depreciation and amortization expense increased by \$1.1 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, mainly due to increased amortization of deferred costs in connection with the throughput deficiency payment discussed above. In addition, depreciation and amortization expense increased due to the completion of various other capital projects.

### ***Crude Oil Pipelines***

Revenues increased \$0.5 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, mainly due to higher tariff rates on virtually all of the crude oil pipelines as the annual index adjustment was effective July 1, 2007.

### ***Crude Oil Storage Tanks***

Throughputs increased 63,061 barrels per day for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to a change in the Corpus Christi (North Beach) crude oil storage tank agreement from a storage lease to a throughput fee agreement effective January 1, 2007. Throughputs for the Corpus Christi (North Beach) crude oil storage tanks were not reported prior to January 1, 2007. However, revenues decreased by \$0.1 million for the three months ended September 30, 2007, compared to the three



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months ended September 30, 2006, primarily due to lower throughputs at Valero Energy's Texas City refinery.

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**Table of Contents**

***Other***

The other segment primarily consists of our marketing and trading organization. This organization purchases heavy fuel oil, asphalt and refined products for resale to third parties. We manage our exposure to price risk associated with these inventories by entering into economic hedges. Additionally, we engage in a limited trading program whereby we enter into derivative commodity instruments for the purpose of generating a profit on market fluctuations. Revenues include the sales of our inventories to third parties and the mark-to-market effects of our trading program. Cost of sales include the cost of our inventories and the mark-to-market effects of our economic hedges. For the three months ended September 30, 2007, our cost of sales exceeded revenues by \$2.2 million primarily due to mark-to-market losses recognized in the third quarter. A portion of these mark-to-market losses related to hedges of physical inventories that will be sold and the margin recognized in the fourth quarter. Operating expenses primarily consist of salaries and wages and terminal storage fees.

***General***

General and administrative expenses increased by \$4.7 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to the following:

increased headcount primarily resulting from a reduction in administrative services received from Valero Energy and increased information systems costs as a result of the separation from Valero Energy;

increased professional fees primarily related to integration consulting and external legal costs; and

increased rent expense due to our new headquarters.

Partially offsetting these increases was a decrease in insurance expense and a decrease in unit option and restricted unit compensation expense as a result of the decrease in the NuStar Energy L.P. unit price during the third quarter of 2007, while the unit price increased in the third quarter of 2006.

Interest expense increased by \$2.8 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to higher average debt balances arising from borrowings used primarily to fund the acquisition of the St. James crude oil storage facility in December 2006 and various terminal expansion projects, partially offset by capitalized interest.

Other income increased by \$13.3 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006, primarily due to the sale of a net profit interest in Wyoming coal properties for \$7.3 million and business interruption insurance income of \$5.4 million associated with the McKee refinery fire. Partially offsetting these increases were foreign exchange losses totaling approximately \$2.7 million relating to a loan between our Canadian subsidiary and one of our U.S. subsidiaries. Proceeds from the business interruption insurance settlement are included in cash flows from operating activities on the consolidated statements of cash flows.

Income tax expense increased \$4.2 million for the three months ended September 30, 2007, compared to the three months ended September 30, 2006. Income tax expense was higher in 2007 primarily due to adjustments resulting from the filing of our 2006 income tax returns, the impact of the Texas margin tax effective January 1, 2007, recording a valuation allowance related to a capital loss carryforward in Canada and other adjustments. These increases were partially offset by a reduction in the United Kingdom income tax rate in the third quarter of 2007.

**Table of Contents***Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006***Financial Highlights**

(Unaudited, Thousands of Dollars, Except Unit and Per Unit Data)

|  | Nine Months Ended<br>September 30, |                   |                 |
|--|------------------------------------|-------------------|-----------------|
|  | 2007                               | 2006              | Change          |
| <b>Statement of Income Data:</b>                                   |                                    |                   |                 |
| <b>Revenues:</b>   |                                    |                   |                 |
| Services revenues  | \$ 503,321                         | \$ 461,911        | \$ 41,410       |
| Product sales  | 508,551                            | 383,084           | 125,467         |
| <b>Total revenues</b>  | <b>1,011,872</b>                   | <b>844,995</b>    | <b>166,877</b>  |
| <b>Costs and expenses:</b>   |                                    |                   |                 |
| Cost of product sales  | 475,011                            | 350,260           | 124,751         |
| Operating expenses   | 258,637                            | 232,727           | 25,910          |
| General and administrative expenses                                | 48,607                             | 30,323            | 18,284          |
| Depreciation and amortization expense                              | 84,736                             | 74,022            | 10,714          |
| <b>Total costs and expenses</b>                                    | <b>866,991</b>                     | <b>687,332</b>    | <b>179,659</b>  |
| <b>Operating income</b>  | <b>144,881</b>                     | <b>157,663</b>    | <b>(12,782)</b> |
| Equity earnings from joint ventures                                | 4,970                              | 4,514             | 456             |
| Interest expense, net  | (57,687)                           | (48,906)          | (8,781)         |
| Other income, net  | 38,915                             | 1,276             | 37,639          |
| <b>Income from continuing operations before income tax expense</b> | <b>131,079</b>                     | <b>114,547</b>    | <b>16,532</b>   |
| Income tax expense   | 9,046                              | 1,997             | 7,049           |
| <b>Income from continuing operations</b>                           | <b>122,033</b>                     | <b>112,550</b>    | <b>9,483</b>    |
| <b>Loss from discontinued operations, net of income tax</b>        |                                    | <b>(377)</b>      | <b>377</b>      |
| <b>Net income</b>  | <b>122,033</b>                     | <b>112,173</b>    | <b>9,860</b>    |
| Less net income applicable to general partner                      | (15,414)                           | (12,550)          | (2,864)         |
| <b>Net income applicable to limited partners</b>                   | <b>\$ 106,619</b>                  | <b>\$ 99,623</b>  | <b>\$ 6,996</b> |
| <b>Weighted-average number of basic units outstanding</b>          | <b>46,809,749</b>                  | <b>46,809,749</b> |                 |
| <b>Income (loss) per unit applicable to limited partners:</b>      |                                    |                   |                 |
| Continuing operations  | \$ 2.28                            | \$ 2.14           | \$ 0.14         |
| Discontinued operations  |                                    | (0.01)            | 0.01            |
| <b>Net income</b>  | <b>\$ 2.28</b>                     | <b>\$ 2.13</b>    | <b>\$ 0.15</b>  |

**Table of Contents****Segment Operating Highlights**

(Thousands of Dollars, Except Barrels/Day Information)

|                                       | Nine Months Ended<br>September 30, |            |            |
|---------------------------------------|------------------------------------|------------|------------|
|                                       | 2007                               | 2006       | Change     |
| <b>Refined Product Terminals:</b>     |                                    |            |            |
| Throughput (barrels/day)              | 242,228                            | 261,619    | (19,391)   |
| Throughput revenues                   | \$ 37,392                          | \$ 36,689  | \$ 703     |
| Storage lease revenues                | 218,044                            | 182,951    | 35,093     |
| Product sales (bunkering)             | 463,739                            | 382,318    | 81,421     |
| Total revenues                        | 719,175                            | 601,958    | 117,217    |
| Cost of product sales                 | 429,391                            | 349,662    | 79,729     |
| Operating expenses                    | 159,350                            | 143,626    | 15,724     |
| Depreciation and amortization expense | 40,566                             | 33,196     | 7,370      |
| Segment operating income              | \$ 89,868                          | \$ 75,474  | \$ 14,394  |
| <b>Refined Product Pipelines:</b>     |                                    |            |            |
| Throughput (barrels/day)              | 661,709                            | 711,215    | (49,506)   |
| Throughput revenues                   | \$ 176,851                         | \$ 162,814 | \$ 14,037  |
| Product sales                         | 4,286                              | 766        | 3,520      |
| Total revenues                        | 181,137                            | 163,580    | 17,557     |
| Cost of product sales                 | 3,051                              | 598        | 2,453      |
| Operating expenses                    | 77,770                             | 69,510     | 8,260      |
| Depreciation and amortization expense | 33,888                             | 31,296     | 2,592      |
| Segment operating income              | \$ 66,428                          | \$ 62,176  | \$ 4,252   |
| <b>Crude Oil Pipelines:</b>           |                                    |            |            |
| Throughput (barrels/day)              | 369,184                            | 426,129    | (56,945)   |
| Revenues                              | \$ 38,077                          | \$ 43,989  | \$ (5,912) |
| Operating expenses                    | 11,839                             | 12,546     | (707)      |
| Depreciation and amortization expense | 3,703                              | 3,809      | (106)      |
| Segment operating income              | \$ 22,535                          | \$ 27,634  | \$ (5,099) |
| <b>Crude Oil Storage Tanks:</b>       |                                    |            |            |
| Throughput (barrels/day)              | 560,394                            | 503,769    | 56,625     |
| Revenues                              | \$ 34,379                          | \$ 35,468  | \$ (1,089) |
| Operating expenses                    | 8,371                              | 7,045      | 1,326      |
| Depreciation and amortization expense | 5,756                              | 5,721      | 35         |
| Segment operating income              | \$ 20,252                          | \$ 22,702  | \$ (2,450) |
| <b>Other:</b>                         |                                    |            |            |
| Product sales                         | \$ 42,106                          |            | \$ 42,106  |
| Cost of product sales                 | 44,166                             |            | 44,166     |
| Operating expenses                    | 2,527                              |            | 2,527      |
| Depreciation and amortization expense | 823                                |            | 823        |

|                          |            |    |            |
|--------------------------|------------|----|------------|
| Segment operating income | \$ (5,410) | \$ | \$ (5,410) |
|--------------------------|------------|----|------------|

**Table of Contents****Segment Operating Highlights (Continued)**

(Thousands of Dollars, Except Barrels/Day Information)

|   | Nine Months Ended<br>September 30, |            | Change      |
|---|------------------------------------|------------|-------------|
|   | 2007                               | 2006       |             |
| <b>Consolidation and Intersegment Eliminations:</b> |                                    |            |             |
| Throughput and storage lease revenues               | \$ (1,422)                         | \$         | \$ (1,422)  |
| Product sales                                       | (1,580)                            |            | (1,580)     |
| Total revenues                                      | (3,002)                            |            | (3,002)     |
| Cost of product sales                               | (1,597)                            |            | (1,597)     |
| Operating expenses                                  | (1,220)                            |            | (1,220)     |
| Total   | \$ (185)                           | \$         | \$ (185)    |
| <b>Consolidated Information:</b>                    |                                    |            |             |
| Revenues  | \$ 1,011,872                       | \$ 844,995 | \$ 166,877  |
| Cost of product sales                               | 475,011                            | 350,260    | 124,751     |
| Operating expenses                                  | 258,637                            | 232,727    | 25,910      |
| Depreciation and amortization expense               | 84,736                             | 74,022     | 10,714      |
| Segment operating income                            | 193,488                            | 187,986    | 5,502       |
| General and administrative expenses                 | 48,607                             | 30,323     | 18,284      |
| Consolidated operating income                       | \$ 144,881                         | \$ 157,663 | \$ (12,782) |

**Highlights**

Net income increased \$9.9 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, due to higher segmental operating income and an increase in other income, partially offset by increased general and administrative expense, interest expense and income tax expense.

Total segment operating income increased \$5.5 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to a \$14.4 million increase in operating income for the refined product terminals segment and a \$4.3 million increase in operating income for the refined product pipelines segment, partially offset by a \$5.4 million decrease in operating income for the other segment, a \$5.1 million decrease in operating income for the crude oil pipelines segment and a \$2.5 million decrease in operating income for the crude oil storage tanks segment.

The throughputs on the refined product pipelines, the refined product terminals and the crude oil pipelines segments were affected by a fire at Valero Energy's McKee refinery in February 2007, which shut down the refinery through mid-April. After the refinery restarted in mid-April, its throughputs increased throughout the second quarter, and it was near capacity by July 2007.

**Refined Product Terminals**

Revenues increased by \$117.2 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to an increase in product sales of \$92.9 million relating to bunker fuel due to increased vessel calls at our St. Eustatius facility, partially offset by a decrease in product sales of \$11.5 million at our Point Tupper facility due to decreased vessel calls. Storage lease revenues increased \$35.1 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, due to the following:

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and increase of \$15.8 million resulting from the St. James terminal acquisition which occurred in December 2006;

an increase in storage lease terminal revenues of \$17.4 million due to additional customers, increased storage utilization and contract extensions by current customers, higher reimbursable project revenue and the effect of foreign exchange rates; and

an increase in revenues of \$1.9 million at our St. Eustatius facility due to leasing additional storage capacity that resulted from completed tank expansion projects.

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**Table of Contents**

Despite lower revenues and throughputs related to our terminals serving the McKee refinery, our revenues increased \$0.7 million primarily due to increased throughput at our terminals serving Valero Energy's Three Rivers refinery.

Cost of product sales increased \$79.7 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, consistent with the increase in product sales revenues. Cost of product sales reflects the cost of bunker fuel sold to marine vessels at our facilities at St. Eustatius in the Caribbean and Point Tupper in Nova Scotia, Canada.

Operating expenses increased \$15.7 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to higher reimbursable project expenses. Reimbursable project expenses are charged back to our customers, and its increase is consistent with the increase in reimbursable project revenues. Operating expenses also increased due to higher salaries and wages, the acquisition of the St. James terminal in December 2006, and higher operating expenses at our St. Eustatius facility resulting from increased vessel calls.

Depreciation and amortization expense increased \$7.4 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, due to the acquisition of the St. James terminal in December 2006 and the completion of various capital projects, including the first phase of the St. Eustatius tank expansion.

***Refined Product Pipelines***

Throughputs decreased 49,506 barrels per day for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to the impact of the McKee refinery fire, offset by increased throughputs on the East Pipeline, North Pipeline and Ammonia Pipeline. Despite lower overall throughputs, revenues increased by \$17.6 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to:

higher tariff rates on virtually all of the refined product pipelines as the annual index adjustment was effective July 1, 2007;

increased revenues and throughputs on the East Pipeline due to the closing of one of our competitor's terminals in the second quarter of 2007 and increased volumes through our North Platte, Nebraska terminal to supply the Colorado market. The East Pipeline also experienced increased throughput due to a turnaround at the Conoco Phillips Ponca City Refinery in prior year and increased product sales;

increased revenues on the Ammonia Pipeline due to a record corn crop;

increased revenues on the Burgos pipeline due to our receipt of an annual throughput deficiency payment in September 2007. In addition, revenues increased due to nine months of operations in 2007 as the Burgos pipeline commenced operations in the middle of the third quarter of 2006.

Cost of product sales increased \$2.5 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, consistent with the increase in product sales revenues.

Operating expenses increased \$8.3 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to higher salaries and wages, higher maintenance and environmental costs, partially offset by lower power costs as a result of decreased throughputs as a consequence of the McKee refinery fire.

Depreciation and amortization expense increased by \$2.6 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, mainly due to increased amortization of deferred costs in connection with the throughput deficiency payment discussed above. In addition, depreciation and amortization expense increased due to the completion of various other capital projects.



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**Table of Contents**

***Crude Oil Pipelines***

Throughputs and revenues decreased for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to the impact of the McKee refinery fire.

***Crude Oil Storage Tanks***

Throughputs increased 56,625 barrels per day for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to a change in the Corpus Christi (North Beach) crude oil storage tank agreement from a storage lease to a throughput fee agreement effective January 1, 2007. Throughputs for the Corpus Christi (North Beach) crude oil storage tanks were not reported prior to January 1, 2007. However, revenues decreased by \$1.1 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to turnarounds at Valero Energy's Benicia, Three Rivers and Corpus Christi refineries and operating issues at Valero Energy's Texas City refinery in January 2007. The Corpus Christi refinery further experienced multiple operating issues during the first half of 2007.

Operating expenses increased by \$1.3 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to increased wharfage and dockage expenses at the Corpus Christi (North Beach) facility.

***Other***

The other segment primarily consists of our marketing and trading organization. This organization purchases heavy fuel oil, asphalt and refined products for resale to third parties. We manage our exposure to price risk associated with these inventories by entering into economic hedges. Additionally, we engage in a limited trading program whereby we enter into derivative commodity instruments for the purpose of generating a profit on market fluctuations. Revenues include the sales of our inventories to third parties and the mark-to-market effects of our trading program. Cost of sales include the cost of our inventories and the mark-to-market effects of our economic hedges. For the nine months ended September 30, 2007, our cost of sales exceeded revenues by \$2.1 million primarily due to mark-to-market losses recognized in the third quarter. A portion of these mark-to-market losses related to hedges of physical inventories that will be sold and the margin recognized in the fourth quarter. Operating expenses primarily consist of salaries and wages and terminal storage fees.

***General***

General and administrative expenses increased by \$18.3 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to the following:

increased expenses associated with unit option and restricted unit compensation expense as a result of the increase in the NuStar Energy L.P. unit price and an increase in the number of awards outstanding;

increased headcount primarily resulting from a reduction in administrative services received from Valero Energy and increased information systems costs as a result of the separation from Valero Energy;

increased professional fees primarily related to external legal costs; and

increased rent expense due to our new headquarters.

Interest expense increased by \$8.8 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to higher average debt balances arising from borrowings used to fund the acquisition of the St. James crude oil storage facility in December 2006 and various terminal expansion projects combined with higher interest rates, partially offset by capitalized interest.

Other income increased by \$37.6 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006, primarily due to a \$13.0 million payment from Valero Energy for exercising its option to terminate the 2007 Services Agreement, business

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interruption insurance income of \$12.5 million associated with the McKee refinery fire, the sale of a net profit interest in Wyoming coal properties for \$7.3 million and a gain of \$5.2 million related to a settlement for the dock damage at our Westwego terminal. Partially offsetting these increases are foreign exchange losses totaling approximately \$6.1 million relating to a loan between our Canadian subsidiary and one of our U.S. subsidiaries. Proceeds from the business interruption insurance settlement are included in cash flows from operating activities on the consolidated statements of cash flows.

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## **Table of Contents**

Income tax expense increased \$7.0 million for the nine months ended September 30, 2007, compared to the nine months ended September 30, 2006. Income tax expense was higher in 2007 primarily due to adjustments resulting from the filing of our 2006 income tax returns, the impact of the Texas margin tax effective January 1, 2007, recording a valuation allowance related to a capital loss carryforward in Canada and other adjustments. These increases were partially offset by a reduction in the United Kingdom income tax rate in the third quarter of 2007.

### **Related Party Transactions**

#### ***Services Agreement***

Prior to our separation from Valero Energy, the employees of NuStar GP, LLC were provided to us under the terms of various services agreements between us and Valero Energy. The terms of these services agreements generally provided that the costs of employees who performed services directly on our behalf, including salaries, wages and employee benefits, were charged directly to us. In addition, Valero Energy charged us an administrative services fee, which was \$0.3 million and \$1.3 million for the three and nine months ended September 30, 2006, respectively.

Although Valero Energy no longer provides employees that work directly on our behalf, Valero Energy continues to provide certain services to us under the terms of a services agreement dated December 22, 2006 (the 2007 Services Agreement). Beginning January 1, 2007, under the 2007 Services Agreement, we pay Valero Energy approximately \$97,000 per month for administrative services (primarily information system services and human resource services) and approximately \$93,000 per month for telecommunication services.

On April 16, 2007, Valero Energy exercised its option to terminate the 2007 Services Agreement. As a result, Valero Energy will cease providing services over a period of time sufficient to allow us to assume those functions. As of September 30, 2007, Valero Energy continues to provide certain human resource services, which are expected to terminate at the end of the year. Additionally, since Valero Energy elected to terminate the 2007 Services Agreement prior to December 31, 2010, they paid us a termination fee of \$13.0 million in May 2007.

#### ***Outlook***

We expect Valero Energy's McKee refinery fire to have a minimal effect on our operations in the fourth quarter of 2007, as the refinery is currently running at or near capacity. Even though we believe we have adequate insurance to cover the amount of losses resulting from the McKee refinery fire, we cannot precisely predict the timing or amounts of insurance proceeds we will receive. As a result, the timing of receiving insurance proceeds will affect our earnings and cash flows in any particular quarter over the next few quarters until we finalize the insurance claim.

We expect our results in the fourth quarter to be lower than the third quarter mainly due to a seasonal decline in product demand, higher operating expenses as we experience increased maintenance activity in the fourth quarter and a lack of one-time income items that we experienced throughout 2007. We may also experience additional volatility in our earnings and cash flows, as we will be exposed to commodity price risk related to the marketing and trading organization.

Despite the decrease from third quarter, we expect our results for the fourth quarter of 2007 to benefit from several of our terminal expansion projects coming on-line, increases in our pipeline tariffs effective July 1 and fewer turnarounds at the refineries we serve.

### **LIQUIDITY AND CAPITAL RESOURCES**

#### ***General***

Our primary cash requirements are for distributions to partners, debt service, reliability and strategic and other capital expenditures, acquisitions and normal operating expenses. We typically generate sufficient cash from our current operations to fund day-to-day operating and general and administrative expenses, reliability capital expenditures and distribution requirements. We also have available borrowing capacity under our existing revolving credit facility and, to the extent necessary, we may raise additional funds through equity or debt offerings under our \$3.0 billion shelf registration statement to fund strategic capital expenditures or other cash requirements not funded from operations. However, there can be no assurance regarding the availability of any additional funds or whether such additional funds can be provided on terms acceptable to us.



**Table of Contents****Cash Flows for the Nine Months Ended September 30, 2007 and 2006**

Net cash provided by operating activities was \$146.8 million for the nine months ended September 30, 2007 compared to \$182.0 million for the nine months ended September 30, 2006. This decrease was primarily due to an increase in inventory related to the marketing and trading organization and increases in other working capital accounts. Net cash provided by operating activities for the nine months ended September 30, 2007 was used to fund distributions to unitholders and the general partner in the aggregate amount of \$145.3 million. The proceeds from long-term debt borrowings, net of repayments, were used to fund a portion of our capital expenditures, primarily related to various terminal expansion projects.

Net cash provided by operating activities for the nine months ended September 30, 2006, combined with available cash on hand, were used to fund distributions to unitholders and the general partner in the aggregate amount of \$135.6 million. The proceeds from long-term debt borrowings totaling \$59.0 million were used to fund the purchase of the Capwood pipeline and a portion of our capital expenditures. The proceeds from the sale of the Australia and New Zealand subsidiaries totaling \$70.1 million were used for working capital purposes, including paying down outstanding debt.

**Partners Equity**

*Cash Distributions.* On July 26, 2007, we declared a quarterly cash distribution of \$0.950 per unit, which was paid on August 14, 2007 to unitholders of record on August 7, 2007, totaling \$49.9 million. On October 25, 2007, we declared a quarterly cash distribution of \$0.985 per unit to be paid on November 14, 2007 to unitholders of record on November 8, 2007, which will total \$52.1 million.

The following table reflects the allocation of total cash distributions to the general and limited partners applicable to the period in which the distributions were earned:

|  | <b>Three Months<br/>Ended<br/>September 30,<br/>2007</b> |                  | <b>Nine Months Ended<br/>September 30,<br/>2007</b> |                   |
|--|--|------------------|---|-------------------|
|  | <b>2007</b>  | <b>2006</b>      | <b>2007</b>   | <b>2006</b>       |
|  | <b>(Thousands of Dollars)</b>                            |                  |   |                   |
| General partner interest                                   | \$ 1,041   | \$ 955           | \$ 2,992  | \$ 2,787          |
| General partner incentive distribution                     | 4,915  | 3,909            | 13,238  | 10,869            |
| <b>Total general partner distribution</b>                  | <b>5,956</b>   | <b>4,864</b>     | <b>16,230</b>                                       | <b>13,656</b>     |
| Limited partners distribution                              | 46,108   | 42,830           | 133,408   | 125,684           |
| <b>Total cash distributions</b>                            | <b>\$ 52,064</b>   | <b>\$ 47,694</b> | <b>\$ 149,638</b>                                   | <b>\$ 139,340</b> |
| Cash distributions per unit applicable to limited partners | \$ 0.985   | \$ 0.915         | \$ 2.850  | \$ 2.685          |

*Shelf Registration.* On May 18, 2007, the SEC declared effective our shelf registration statement on Form S-3, which will permit us to offer and sell various types of securities, including NuStar Energy L.P. common units and debt securities of each NuStar Logistics and KPOP, having an aggregate value of up to \$3.0 billion. We filed the registration statement to gain additional flexibility in accessing capital markets for, among other things, the repayment of outstanding indebtedness, working capital, capital expenditures and acquisitions.

**Capital Requirements**

The petroleum pipeline and terminalling industry is capital intensive, requiring significant investments to maintain, upgrade or enhance existing operations and to comply with environmental and safety laws and regulations.

Our capital expenditures consist primarily of:

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reliability capital expenditures, formerly referred to as maintenance capital expenditures, such as those required to maintain equipment reliability and safety and to address environmental and safety regulations; and

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## **Table of Contents**

strategic capital expenditures, such as those to expand and upgrade pipeline capacity and to construct new pipelines, terminals and storage tanks. In addition, strategic capital expenditures may include acquisitions of pipelines, terminals or storage tank assets. During the nine months ended September 30, 2007, we incurred reliability capital expenditures of \$23.6 million, primarily related to system automation and maintenance upgrade projects at our terminals and pipelines. Strategic and other capital expenditures of \$146.9 million during the nine months ended September 30, 2007, primarily related to the Amsterdam, St. Eustatius and St. James tank expansions and other terminal expansion projects, as well as expenditures required as a result of our separation from Valero Energy, such as separating our information systems and improvements made to our new headquarters.

For the full year of 2007, we expect to incur approximately \$270.0 million of capital expenditures, including \$42.0 million for reliability capital projects and \$228.0 million for strategic and other capital projects, including \$14.0 million for capital expenditures required as a result of our separation from Valero Energy. We continuously evaluate our capital budget and make changes as economic conditions warrant. If conditions warrant, our actual capital expenditures for 2007 may exceed the budgeted amounts.

As our marketing and trading organization continues to grow, we expect to continue to acquire inventory to support that organization. The timing of such purchases compared to the collection of cash from our customers related to sales may impact the amount of cash generated from our operations. However, we believe cash generated from operations combined with other sources of liquidity will be sufficient to fund our capital requirements in 2007.

### ***Long-Term Contractual Obligations***

#### ***Extension of Maturity Date***

In accordance with the terms of our \$600 Million Revolving Credit Agreement (Revolving Credit Agreement) and \$525 Million Term Loan Agreement (Term Loan Agreement), we requested a one-year extension to the maturity dates of those agreements. In June 2007, the lenders consented to our request thereby extending the maturity dates of our Revolving Credit Agreement and our Term Loan Agreement to May 31, 2012.

#### ***Revolving Credit Agreement***

The Revolving Credit Agreement bears interest based on either an alternative base rate or LIBOR, which was 5.8% as of September 30, 2007. As of September 30, 2007, we had \$225.5 million available for borrowing under our Revolving Credit Agreement.

#### ***Interest Rate Swaps***

As of September 30, 2007, the weighted-average interest rate for our interest rate swaps was 6.3%. As of September 30, 2007 and December 31, 2006, the aggregate estimated fair value of the interest rate swaps included in other long-term liabilities in our consolidated balance sheets was \$3.0 million and \$4.9 million, respectively.

#### ***Environmental, Health and Safety***

We are subject to extensive federal, state and local environmental and safety laws and regulations, including those relating to the discharge of materials into the environment, waste management, pollution prevention measures, pipeline integrity and operator qualifications, among others. Because environmental and safety laws and regulations are becoming more complex and stringent and new environmental and safety laws and regulations are continuously being enacted or proposed, the level of future expenditures required for environmental, health and safety matters is expected to increase.

#### ***Other Contingencies***

We are subject to certain loss contingencies, the outcome of which could have an effect on our cash flows and results of operations. Specifically, we may be required to make substantial payments to the U.S. Department of Justice for certain remediation costs as further disclosed in Note 5 of Condensed Notes to Consolidated Financial Statements.

**Table of Contents**

***Commitments***

In the first quarter of 2007, we entered into a three-year agreement to purchase a minimum of 4.5 million barrels of bunker fuel at market prices for resale to our customers. We estimated the value of this commitment to be approximately \$203.0 million, which will fluctuate with market prices.

The building lease for our new headquarters became effective in the first quarter of 2007. We have a minimum commitment of approximately \$13.5 million over almost 11 years.

**CRITICAL ACCOUNTING POLICIES**

The preparation of financial statements in accordance with United States generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2006.

***Derivative and Financial Instruments***

We began utilizing various derivative instruments to manage our exposure to commodity price risk and engage in a limited trading program in 2007. All derivative instruments are recorded in the consolidated balance sheet as either assets or liabilities at their fair value. We manage our exposure to price fluctuations with respect to our inventory of heavy fuels and refined products with economic hedges. Changes in the fair values of our economic hedges generally are offset, at least partially, by changes in the values of the hedged physical inventory. Our economic hedges do not receive hedge accounting treatment under Statement of Financial Accounting Standards No. 133 (Statement No. 133). We record these derivative instruments in the consolidated balance sheet at fair value with mark-to-market adjustments recorded in cost of sales. Trading derivative instruments are financial positions entered into without underlying physical inventory and are not considered economic hedges. We record these derivative instruments in the consolidated balance sheet at fair value, with mark-to-market adjustments recorded in revenues.



**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk****Interest Rate Risk**

We manage our debt considering various financing alternatives available in the market and we manage our exposure to changing interest rates principally through the use of a combination of fixed-rate debt and variable-rate debt. In addition, we utilize interest rate swap agreements to manage a portion of the exposure to changing interest rates by converting certain fixed-rate debt to variable-rate debt. Borrowings under the Revolving Credit Agreement and Term Loan Agreement expose us to increases in the benchmark interest rate underlying these variable rate debt instruments.

The following table provides information about our long-term debt and interest rate derivative instruments, all of which are sensitive to changes in interest rates. For long-term debt, principal cash flows and related weighted-average interest rates by expected maturity dates are presented. For interest rate swaps, the table presents notional amounts and weighted-average interest rates by expected (contractual) maturity dates. Weighted-average variable rates are based on implied forward interest rates in the yield curve at the reporting date.

|   | September 30, 2007                            |        |        |        |           |            | There-<br>after | Total      | Fair<br>Value |
|---|---|--------|--------|--------|-----------|------------|-----------------|------------|---------------|
|   | Expected Maturity Dates                       |        |        |        |           |            |                 |            |               |
|   | 2007  | 2008   | 2009   | 2010   | 2011      |            |                 |            |               |
|   | (Thousands of Dollars, Except Interest Rates) |        |        |        |           |            |                 |            |               |
| <b>Long-term Debt:</b>                        |   |        |        |        |           |            |                 |            |               |
| Fixed rate                                    | \$ 1,861                                      | \$ 660 | \$ 713 | \$ 770 | \$ 43,689 | \$ 833,980 | \$ 881,673      | \$ 916,481 |               |
| Average interest rate                         | 6.5%  | 8.0%   | 8.0%   | 8.0%   | 6.7%      | 6.6%       | 6.6%            |            |               |
| Variable rate                                 | \$  | \$     | \$     | \$     | \$        | \$ 596,562 | \$ 596,562      | \$ 596,562 |               |
| Average interest rate                         |   |        |        |        |           | 6.0%       | 6.0%            |            |               |
| <b>Interest Rate Swaps Fixed to Variable:</b> |   |        |        |        |           |            |                 |            |               |
| Notional amount                               | \$  | \$     | \$     | \$     | \$        | \$ 167,500 | \$ 167,500      | \$ (3,000) |               |
| Average pay rate                              | 6.3%  | 6.1%   | 6.5%   | 6.8%   | 7.0%      | 7.1%       | 6.7%            |            |               |
| Average receive rate                          | 6.3%  | 6.3%   | 6.3%   | 6.3%   | 6.3%      | 6.2%       | 6.3%            |            |               |

|   | December 31, 2006                             |        |        |        |            |            | There-<br>after | Total      | Fair Value |
|---|---|--------|--------|--------|------------|------------|-----------------|------------|------------|
|   | Expected Maturity Dates                       |        |        |        |            |            |                 |            |            |
|   | 2007  | 2008   | 2009   | 2010   | 2011       |            |                 |            |            |
|   | (Thousands of Dollars, Except Interest Rates) |        |        |        |            |            |                 |            |            |
| <b>Long-term Debt:</b>                        |   |        |        |        |            |            |                 |            |            |
| Fixed rate                                    | \$ 647  | \$ 660 | \$ 713 | \$ 770 | \$ 41,950  | \$ 854,049 | \$ 898,789      | \$ 939,191 |            |
| Average interest rate                         | 8.0%  | 8.0%   | 8.0%   | 8.0%   | 6.7%       | 6.6%       | 6.6%            |            |            |
| Variable rate                                 | \$  | \$     | \$     | \$     | \$ 415,526 | \$         | \$ 415,526      | \$ 415,526 |            |
| Average interest rate                         |   |        |        |        | 6.1%       |            | 6.1%            |            |            |
| <b>Interest Rate Swaps Fixed to Variable:</b> |   |        |        |        |            |            |                 |            |            |
| Notional amount                               | \$  | \$     | \$     | \$     | \$         | \$ 167,500 | \$ 167,500      | \$ (4,908) |            |
| Average pay rate                              | 7.0%  | 6.7%   | 6.7%   | 6.8%   | 6.9%       | 6.8%       | 6.8%            |            |            |
| Average receive rate                          | 6.3%  | 6.3%   | 6.3%   | 6.3%   | 6.3%       | 6.2%       | 6.3%            |            |            |

**Table of Contents****Commodity Price Risk**

We created a marketing and trading organization to capitalize on opportunities to optimize the use and profitability of our assets, to manage our risk as we diversify our business and to enhance our competitive position when pursuing acquisitions. We purchase heavy fuel oil, asphalt and refined products for resale to third parties, which exposes us to fluctuations in commodity prices.

We have a risk management group that has direct oversight responsibilities for our risk policies and our trading controls and procedures and certain aspects of risk management. Our risk management group also approves all new risk management strategies through a formal process.

We manage our exposure to price fluctuations with respect to our inventory of heavy fuels and refined products with economic hedges. The derivative instruments we use consist primarily of futures contracts and swaps traded on the NYMEX. Changes in the fair values of our economic hedges generally are offset, at least partially, by changes in the values of the hedged physical inventory. However, our economic hedges do not receive hedge accounting treatment under Statement of Financial Accounting Standards No. 133 (Statement No. 133). We record these derivative instruments in the consolidated balance sheet at fair value with mark-to-market adjustments recorded in cost of sales.

On a limited basis, we also enter into derivative commodity instruments based on our fundamental and technical analysis of market conditions in order to profit from market fluctuations. These derivative instruments are financial positions entered into without underlying physical inventory and are not considered economic hedges. We record these derivative instruments in the consolidated balance sheet at fair value, with mark-to-market adjustments recorded in revenues.

|  | Contract<br>Volumes       | September 30, 2007            |               | Fair Value of<br>Current<br>Asset (Liability)<br>(Thousands<br>of Dollars) |
|--|---------------------------|-------------------------------|---------------|--|
|  |                           | Weighted Average<br>Pay Price | Receive Price |  |
|  | (Thousands<br>of Barrels) |                               |               |  |
| <b>Economic Hedges:</b>                            |                           |                               |               |  |
| Futures long:<br>(refined products)                | 171                       | \$ 83.33                      | N/A           | \$ 409   |
| Futures short:<br>(refined products)               | 602                       | N/A                           | \$ 88.52      | (519)  |
| <b>Trading Activities:</b>                         |                           |                               |               |  |
| Futures long:<br>(crude oil and refined products)  | 395                       | \$ 82.97                      | N/A           | 184  |
| Futures short:<br>(crude oil and refined products) | 512                       | N/A                           | \$ 82.46      | (809)  |
| Swaps long:<br>(heavy products)                    | 300                       | \$ 53.71                      | \$ 58.18      | 1,339  |
| Swaps short:<br>(heavy products)                   | 250                       | \$ 58.08                      | \$ 53.28      | (1,201)  |
| <b>Total fair value of open positions</b>          |                           |                               |               | \$ (597)   |

**Table of Contents**

**Item 4. Controls and Procedures**

*(a) Evaluation of disclosure controls and procedures.*

Our management has evaluated, with the participation of the principal executive officer and principal financial officer of NuStar GP, LLC, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report, and has concluded that our disclosure controls and procedures were effective as of September 30, 2007.

*(b) Changes in internal control over financial reporting.*

There has been no change in our internal control over financial reporting that occurred during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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**Table of Contents**

## PART II OTHER INFORMATION

**Item 1. Legal Proceedings**

The information below describes new proceedings or material developments in proceedings that we previously reported in our annual report on Form 10-K for the year ended December 31, 2006.

***PORT OF VANCOUVER MATTER***

We own a chemical and refined product terminal on property owned by the Port of Vancouver, and we lease the land under the terminal from the Port of Vancouver. Under an Agreed Order entered into with the Washington Department of Ecology when Kaneb purchased the terminal in 1998, Kaneb agreed to investigate and remediate groundwater contamination by the terminal's previous owner and operator originating from the terminal. Investigation and remediation at the terminal are ongoing in compliance with the Agreed Order. In April 2006, the Washington Department of Ecology commented on our site investigation work plan and asserted that the groundwater contamination at the terminal was commingled with a groundwater contamination plume under other property owned by the Port of Vancouver. Since that time, we have negotiated with the Washington Department of Ecology, and on November 7, 2007, we entered into an Agreed Order that outlines a plan for site assessment, monitoring and interim action with regard to the plume for which Kaneb is responsible. The Agreed Order contains a diagram indicating that the plume for which Kaneb is responsible is separate from proximately located plumes.

**Item 1A. Risk Factors**

***Our pending acquisition of CITGO Asphalt Refining Company's East Coast Asphalt Operations may not be successful and we may not realize the anticipated benefits from this acquisition.***

We may be unable to obtain the governmental and regulatory approvals necessary in order to consummate the acquisition of the East Coast Asphalt Operations. Further, the other customary conditions to closing may not be satisfied, or the parties may agree to terminate the agreement, and as a result we may not be able to consummate the transaction without a material adjustment to its proposed terms or at all, which may have an adverse effect on the trading price of our units. Even if we do obtain all required approvals, and even if the other conditions to the consummation of the acquisition are satisfied, our acquisition of the East Coast Asphalt Operations may pose risks to our business. In addition to the risks ordinarily associated with an acquisition, we will also be exposed to risks specific to the East Coast Asphalt Operations, such as:

earnings volatility;

additional working capital requirements;

dependence on Petr oleos de Venezuela S.A. as the exclusive supplier of crude oil; and

the asphalt operations' exposure to the volatility of the cost of crude oil and the price and volumes at which asphalt may be sold. Accordingly, we may not be able to realize strategic, operational and financial benefits as a result of the East Coast Asphalt Operations acquisition, which could adversely affect our operating and financial results.

In addition, we will face certain challenges as we work to integrate the asphalt operations into our business. In particular, the acquisition of the East Coast Asphalt Operations will, by adding two refineries, expand our operations and the types of businesses in which we engage, significantly expanding our geographic scope and increasing the number of our employees, thereby presenting us with significant challenges as we work to manage the increase in scale resulting from the acquisition. We must integrate a large number of systems, both operational and administrative, which we have not historically used in our operations. Delays in this process could have a material adverse effect on our revenues, expenses, operating results and financial condition. In addition, events outside of our control, including changes in state and federal

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regulation and laws as well as economic trends, also could adversely affect our ability to realize the anticipated benefits from the acquisition of the East Coast Asphalt Operations.

Further, the asphalt operations may not perform in accordance with our expectations, we may lose customers or key employees, and our expectations with regards to integration and synergies may not be fully realized. Our failure to successfully integrate and operate the asphalt refineries, and to realize the anticipated benefits of the acquisition, could adversely affect our operating and financial results.

### Item 6. Exhibits

- Exhibit 10.01 Form of Non-employee Director Restricted Unit Agreement under NuStar GP, LLC's Second Amended and Restated 2000 Long-Term Incentive Plan- incorporated by reference to Exhibit 10.02 to NuStar Energy L.P.'s Current Report on Form 8-K dated October 24, 2007 and filed October 29, 2007.
- +Exhibit 10.02 Form of Restricted Unit Award under NuStar GP, LLC's Second Amended and Restated 2000 Long-Term Incentive Plan- incorporated by reference to Exhibit 10.03 to NuStar Energy L.P.'s Current Report on Form 8-K dated October 24, 2007 and filed October 29, 2007.
- \*Exhibit 12.01 Statement of Computation of Ratio of Earnings to Fixed Charges.
- \*Exhibit 31.01 Rule 13a-14(a) Certifications (under Section 302 of the Sarbanes-Oxley Act of 2002).
- \*Exhibit 32.01 Section 1350 Certifications (as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002).

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\* Filed herewith.

+ Identifies management contracts or compensatory plans or arrangements required to be filed as an exhibit hereto.

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**NUSTAR ENERGY L.P.**

**(Registrant)**

**By: Riverwalk Logistics, L.P., its general partner**

**By: NuStar GP, LLC, its general partner**

**By: /s/ Curtis V. Anastasio**

**Curtis V. Anastasio**

**President and Chief Executive Officer**

**November 9, 2007**

**By: /s/ Steven A. Blank**

**Steven A. Blank**

**Senior Vice President, Chief Financial Officer and Treasurer**

**November 9, 2007**

**By: /s/ Thomas R. Shoaf**

**Thomas R. Shoaf**

**Vice President and Controller**

**November 9, 2007**