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Blueknight Energy Partners, L.P.  
Form 10-Q  
November 01, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 001-33503

BLUEKNIGHT ENERGY PARTNERS, L.P.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

20-8536826  
(IRS Employer  
Identification No.)

201 NW 10th, Suite 200  
Oklahoma City, Oklahoma 73103  
(Address of principal executive offices, zip code)

Registrant's telephone number, including area code: (405) 278-6400

(Former name, former address and former fiscal year, if changed since last report)

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 has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):  
Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 25, 2018, there were 35,125,202 Series A Preferred Units and 40,393,743 common units outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Unaudited Condensed Consolidated Financial Statements

BLUEKNIGHT ENERGY PARTNERS, L.P.  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (in thousands, except unit data)

	As of December 31, 2017 (unaudited)	As of September 30, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$2,469	\$ 1,926
Accounts receivable, net of allowance for doubtful accounts of \$28 at both dates	7,589	46,917
Receivables from related parties, net of allowance for doubtful accounts of \$0 at both dates	3,070	1,647
Prepaid insurance	2,009	2,146
Other current assets	8,438	9,834
Total current assets	23,575	62,470
Property, plant and equipment, net of accumulated depreciation of \$316,591 and \$276,290 at December 31, 2017, and September 30, 2018, respectively	296,069	295,272
Goodwill	3,870	6,728
Debt issuance costs, net	4,442	3,600
Intangibles and other assets, net	12,913	18,169
Total assets	\$340,869	\$ 386,239
<b>LIABILITIES AND PARTNERS' CAPITAL</b>		
Current liabilities:		
Accounts payable	\$4,439	\$ 4,311
Accounts payable to related parties	2,268	3,093
Accrued crude oil purchases	1,115	15,142
Accrued crude oil purchases to related parties	—	16,681
Accrued interest payable	694	462
Accrued property taxes payable	2,432	3,776
Unearned revenue	2,393	3,207
Unearned revenue with related parties	551	2,809
Accrued payroll	6,119	3,838
Other current liabilities	3,632	3,820
Total current liabilities	23,643	57,139
Long-term unearned revenue with related parties	1,052	745
Other long-term liabilities	3,673	3,726
Long-term interest rate swap liabilities	225	—
Long-term debt	307,592	271,592
Commitments and contingencies (Note 15)		
Partners' capital:		
Common unitholders (40,158,342 and 40,387,006 units issued and outstanding at December 31, 2017, and September 30, 2018, respectively)	454,358	429,959
Preferred Units (35,125,202 units issued and outstanding at both dates)	253,923	253,923
General partner interest (1.6% interest with 1,225,409 general partner units outstanding at both dates)	(703,597 )	(630,845 )

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Total partners' capital	4,684	53,037
Total liabilities and partners' capital	\$340,869	\$ 386,239

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.  
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (in thousands, except per unit data)

	Three Months ended September 30,		Nine Months ended September 30,	
	2017	2018	2017	2018
	(unaudited)			
Service revenue:				
Third-party revenue	\$30,635	\$12,743	\$87,443	\$44,164
Related-party revenue	14,464	5,396	41,611	17,780
Lease revenue:				
Third-party revenue	—	11,368	—	31,409
Related-party revenue	—	5,406	—	20,584
Product sales revenue:				
Third-party revenue	2,375	97,763	8,637	146,892
Related-party revenue	—	482	—	482
Total revenue	47,474	133,158	137,691	261,311
Costs and expenses:				
Operating expense	29,380	27,174	91,896	87,297
Cost of product sales	1,675	50,815	6,483	73,493
Cost of product sales from related party	—	44,106	—	67,853
General and administrative expense	4,093	4,322	13,000	13,029
Asset impairment expense	—	15	45	631
Total costs and expenses	35,148	126,432	111,424	242,303
Gain (loss) on sale of assets	(107 )	(63 )	(986 )	300
Operating income	12,219	6,663	25,281	19,308
Other income (expenses):				
Equity earnings in unconsolidated affiliate	—	—	61	—
Gain on sale of unconsolidated affiliate	1,112	—	5,284	2,225
Interest expense	(3,500 )	(4,090 )	(10,795 )	(12,683 )
Income before income taxes	9,831	2,573	19,831	8,850
Provision for income taxes	60	165	147	215
Net income	\$9,771	\$2,408	\$19,684	\$8,635
Allocation of net income for calculation of earnings per unit:				
General partner interest in net income	\$312	\$39	\$777	\$298
Preferred interest in net income	\$6,279	\$6,279	\$18,837	\$18,836
Net income (loss) available to limited partners	\$3,180	\$(3,910 )	\$70	\$(10,499 )
Basic and diluted net income (loss) per common unit	\$0.08	\$(0.09 )	\$—	\$(0.25 )
Weighted average common units outstanding - basic and diluted	38,189	40,380	38,164	40,331

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.  
 CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN PARTNERS' CAPITAL (DEFICIT)  
 (in thousands)

	Common Unitholders	Series A Preferred Unitholders	General Partner Interest	Total Partners' Capital (Deficit)
	(unaudited)			
Balance, December 31, 2017	\$454,358	\$ 253,923	\$(703,597)	\$4,684
Net income (loss)	(10,655 )	18,836	454	8,635
Equity-based incentive compensation	1,325	—	27	1,352
Distributions	(15,277 )	(18,836 )	(879 )	(34,992 )
Capital contributions	—	—	183	183
Capital contributions related to sale of terminal assets to Ergon	—	—	72,967	72,967
Proceeds from sale of 61,327 common units pursuant to the Employee Unit Purchase Plan	208	—	—	208
Balance, September 30, 2018	\$429,959	\$ 253,923	\$(630,845)	\$53,037

The accompanying notes are an integral part of this unaudited condensed consolidated financial statement.

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BLUEKNIGHT ENERGY PARTNERS, L.P.  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (in thousands)

	Nine Months ended September 30, 2017    2018 (unaudited)	
Cash flows from operating activities:		
Net income	\$19,684	\$8,635
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for uncollectible receivables from third parties	(19 )	—
Depreciation and amortization	23,586	21,945
Amortization and write-off of debt issuance costs	1,560	1,200
Unrealized gain related to interest rate swaps	(1,253 )	(277 )
Intangible asset impairment charge	—	189
Fixed asset impairment charge	45	442
Loss (gain) on sale of assets	986	(300 )
Gain on sale of unconsolidated affiliate	(5,284 )	(2,225 )
Equity-based incentive compensation	913	1,352
Equity earnings in unconsolidated affiliate	(61 )	—
Changes in assets and liabilities:		
Increase in accounts receivable	(352 )	(39,328)
Decrease (increase) in receivables from related parties	(110 )	1,423
Decrease in prepaid insurance	1,964	1,817
Decrease (increase) in other current assets	53	(949 )
Decrease in other non-current assets	56	424
Decrease in accounts payable	(142 )	(435 )
Increase in payables to related parties	159	1,068
Increase in accrued crude oil purchases	785	15,142
Increase in accrued crude oil purchases to related parties	—	16,681
Increase (decrease) in accrued interest payable	338	(232 )
Increase in accrued property taxes	1,187	1,718
Increase in unearned revenue	775	853
Increase in unearned revenue from related parties	3,835	2,829
Decrease in accrued payroll	(804 )	(2,281 )
Decrease in other accrued liabilities	(1,720 )	(1,504 )
Net cash provided by operating activities	46,181	28,187
Cash flows from investing activities:		
Acquisitions	—	(21,959)
Capital expenditures	(13,312 )	(29,560)
Proceeds from sale of assets	9,202	4,707
Proceeds from sale of terminal assets to Ergon	—	88,538
Proceeds from sale of unconsolidated affiliate	26,436	2,225
Net cash provided by investing activities	22,326	43,951
Cash flows from financing activities:		
Payment on insurance premium financing agreement	(2,074 )	(1,722 )
Debt issuance costs	(4,172 )	(358 )
Borrowings under credit agreement	344,592	216,000

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Payments under credit agreement	(371,000)	(252,000)
Proceeds from equity issuance	240	208
Capital contributions	104	183
Distributions	(36,853 )	(34,992)
Net cash used in financing activities	(69,163 )	(72,681)
Net decrease in cash and cash equivalents	(656 )	(543 )
Cash and cash equivalents at beginning of period	3,304	2,469
Cash and cash equivalents at end of period	\$2,648	\$1,926

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BLUEKNIGHT ENERGY PARTNERS, L.P.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

Supplemental disclosure of non-cash financing and investing cash flow information:

Non-cash changes in property, plant and equipment	\$717	\$(908 )
Non-cash change in assets and liabilities due to settlement items related to the sale of terminal assets to Ergon	\$—	\$(1,308)
Increase in accrued liabilities related to insurance premium financing agreement	\$2,938	\$2,225

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.

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BLUEKNIGHT ENERGY PARTNERS, L.P.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND NATURE OF BUSINESS

Blueknight Energy Partners, L.P. and subsidiaries (collectively, the “Partnership”) is a publicly traded master limited partnership with operations in 27 states. The Partnership provides integrated terminalling, gathering, transportation and marketing services for companies engaged in the production, distribution and marketing of crude oil and asphalt products. The Partnership manages its operations through four operating segments: (i) asphalt terminalling services, (ii) crude oil terminalling services, (iii) crude oil pipeline services and (iv) crude oil trucking services. On April 24, 2018, the Partnership sold the producer field services business. As a result of the sale of the producer field services business, the Partnership changed the name of the crude oil trucking and producer field services operating segment to crude oil trucking services during the second quarter of 2018. See Note 6 for additional information. The Partnership’s common units and preferred units, which represent limited partnership interests in the Partnership, are listed on the NASDAQ Global Market under the symbols “BKEP” and “BKEPP,” respectively. The Partnership was formed in February 2007 as a Delaware master limited partnership initially to own, operate and develop a diversified portfolio of complementary midstream energy assets.

2. BASIS OF CONSOLIDATION AND PRESENTATION

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”). The condensed consolidated balance sheet as of September 30, 2018, the condensed consolidated statements of operations for the three and nine months ended September 30, 2017 and 2018, the condensed consolidated statement of changes in partners’ capital (deficit) for the nine months ended September 30, 2018, and the condensed consolidated statements of cash flows for the nine months ended September 30, 2017 and 2018, are unaudited. In the opinion of management, the unaudited condensed consolidated financial statements have been prepared on the same basis as the audited financial statements and include all adjustments necessary to state fairly the financial position and results of operations for the respective interim periods. All adjustments are of a recurring nature unless otherwise disclosed herein. The 2017 year-end condensed consolidated balance sheet data was derived from audited financial statements but does not include all disclosures required by GAAP. These unaudited condensed consolidated financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto included in the Partnership’s annual report on Form 10-K for the year ended December 31, 2017, filed with the Securities and Exchange Commission (the “SEC”) on March 8, 2018 (the “2017 Form 10-K”). Interim financial results are not necessarily indicative of the results to be expected for an annual period. The Partnership’s significant accounting policies are consistent with those disclosed in Note 3 of the Notes to Consolidated Financial Statements in its 2017 Form 10-K.

The Partnership’s investment in Advantage Pipeline, L.L.C. (“Advantage Pipeline”), over which the Partnership had significant influence but not control, was accounted for by the equity method. The Partnership did not consolidate any part of the assets or liabilities of its equity investee. The Partnership’s share of net income or loss is reflected as one line item on the Partnership’s unaudited condensed consolidated statements of operations entitled “Equity earnings in unconsolidated affiliate” and increased or decreased, as applicable, the carrying value of the Partnership’s “Investment in unconsolidated affiliate” on the unaudited condensed consolidated balance sheets. Distributions to the Partnership reduced the carrying value of its investment and, to the extent received, were reflected in the Partnership’s unaudited condensed consolidated statements of cash flows in the line item “Distributions from unconsolidated affiliate.” Contributions increased the carrying value of the Partnership’s investment and were reflected in the Partnership’s unaudited condensed consolidated statements of cash flows in investing activities. On April 3, 2017, the Partnership sold its investment in Advantage Pipeline. See Note 5 for additional information.

A reclassification has been made in the consolidated balance sheet as of December 31, 2017, to conform to the 2018 financial statement presentation. This was a reclassification of “Accrued crude oil purchases” from “Accrued liabilities.” The reclassification has no impact on net income.

### 3. REVENUE

#### Revenue from Contracts with Customers

On January 1, 2018, the Partnership adopted the new accounting standard ASC 606 - Revenue from Contracts with Customers and all related amendments (“new revenue standard”) using the modified retrospective method, and as a result applied the new guidance only to contracts that are not completed at the adoption date. Results for reporting periods beginning on January 1, 2018, are presented under the new revenue standard, while prior period amounts are not adjusted and continue to be reported in accordance with the Partnership’s historic accounting under ASC 605 - Revenue Recognition.

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The majority of the Partnership's service revenue continues to be recognized as services are performed. Under the new revenue standard, the timing of revenue recognition on variable throughput fees will change, within a single reporting year, compared to the previous recognition. The effect will be straight-line recognition of unconstrained estimated annual throughput volumes over each contract year. See further discussion on variable throughput fees below. In addition, as a result of the adoption of the new revenue standard, revenue from leases is required to be presented separately from revenue from customers. As the Partnership applied the modified retrospective method, prior periods have not been reclassified.

Upon adoption of the new revenue standard, there was no cumulative adjustment to the balance sheet at January 1, 2018. Adoption of the new revenue standard resulted in recognizing \$1.6 million and \$1.3 million less "Service revenue - Third-party revenue" in the unaudited condensed consolidated statements of operations for the three and nine months ended September 30, 2018, respectively, and additional "Accounts receivable" of \$0.2 million on the unaudited condensed consolidated balance sheet as of September 30, 2018, over what would have been recorded under ASC 605. This represents a shift in revenue recognition between quarters within the fiscal year, and the difference is anticipated to be recognized during the fourth quarter of 2018. The impact of adoption of the new revenue standard is not expected to be material to net income on an ongoing basis because the analysis of contracts under the new revenue standard supports the recognition of revenue as services are performed, which is consistent with the previous revenue recognition model.

There are two types of contracts in the asphalt terminalling segment: (i) operating lease contracts, under which customers operate the facilities, and (ii) storage, throughput and handling contracts, under which the Partnership operates the facilities. The operating lease contracts are accounted for in accordance with ASC 840 - Leases. The storage, throughput and handling contracts contain both lease revenue and non-lease service revenue. In accordance with ASC 840 and 606, fixed consideration is allocated to the lease and service components based on their relative stand-alone selling price. The stand-alone selling price of the lease component is calculated using the average internal rate of return under the operating lease agreements. The stand-alone selling price of the service component is calculated by applying an appropriate margin to the expected costs to operate the facility. The service component contains a single performance obligation that consists of a stand-ready obligation to perform activities as directed by the customer. Revenue is recognized on a straight-line basis over time as the customer receives and consumes benefits. Fixed consideration, consisting of the monthly storage and handling fees, is billed a month prior to the performance of services and is due by the first day of the month of service. Payments received in advance of the month of service are recorded as unearned revenue (contract liability) until the service is performed.

Asphalt storage, throughput and handling contracts also contain variable consideration in the form of reimbursements of utility, fuel and power expenses and throughput fees. Utility, fuel and power reimbursements are allocated entirely to the service component of the contracts. Utility, fuel and power reimbursements relate directly to the distinct monthly service that makes up the overall performance obligation and revenue is recognized in the period in which the service takes place. Variable consideration related to reimbursements of utility, fuel and power expenses is billed in the month subsequent to the period of service, and payment is due within 30 days of billing. Throughput fees are allocated to both the lease and service component of the contracts using the allocation percentages from contract inception. Total throughput fees are estimated at contract inception and updated at the beginning of each reporting period based on historical trends, current year throughput activities at the facilities, and analysis with customers regarding expectations for the current year. This consideration can be constrained when there is a lack of historical data or other uncertainties exist regarding expected throughput volumes. The service component of throughput fees is recognized on a straight-line basis over time as the customer receives and consumes benefits. In accordance with ASC 840, the lease component of variable throughput fees is recognized in the period when the changes in facts and circumstances on which the variable payment is based occur. Fees related to actual throughput are billed in the month subsequent to the period of movement, which can result in the recognition of un-billed accounts receivable (contract

assets) when there is a variance in the straight-line revenue recognition and actual throughput fees billed. Payment on variable throughput consideration is due within 30 days of billing. Changes in estimated throughput fees affect the total transaction price and will be recorded as an adjustment to revenue in the period in which the change is identified. The Partnership recorded a decrease to revenue of \$0.1 million related to changes in estimated throughput fees for the three months ended September 30, 2018.

Certain asphalt storage, throughput and handling contracts contain provisions for reimbursement of specified major maintenance costs above a specified threshold over the life of the contract. Reimbursements of specified major maintenance costs are allocated to both the lease and service component of the contracts using the allocation percentages from contract inception. Reimbursements of specified major maintenance costs are reviewed and paid quarterly, which may result in overpayments that must be paid back to the customer in future years. As such, the service component of this consideration is constrained and recorded in unearned revenue (contract liability) until facts and circumstances indicate it is probable that the minimum threshold will be met. In the event the minimum threshold is not met, the Partnership will return the reimbursement to the customer.

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As of September 30, 2018, the Partnership has performance obligations satisfied over time under asphalt storage, throughput and handling contracts that are wholly or partially unsatisfied. The revenue related to these performance obligations will be recognized as follows (in thousands):

Revenue Related to Future Performance Obligations Due by Period <sup>(1)</sup>	
Less than 1 year	\$28,299
1-3 years	51,848
4-5 years	32,536
More than 5 years	10,320
Total revenue related to future performance obligations	\$123,003

(1) Excluded from the table is revenue that is either constrained or related to performance obligations that are wholly unsatisfied as of September 30, 2018.

Crude oil terminalling services contracts can be either short- or long-term written contracts. The contracts contain a single performance obligation that consists of a series of distinct services provided over time. Customers are billed a month prior to the performance of terminalling services and payment is due by the first day of the month of service. Payments received in advance of the month of service are recorded as unearned revenue (contract liability) until the service is performed. These contracts also contain provisions under which customers are invoiced for product throughput in the month following the month in which the service is provided. Payment on product throughput is due within 30 days. The Partnership has elected to use the right-to-invoice expedient on crude oil terminalling services contracts as the right to consideration corresponds directly with the value to the customer of performance completed to date.

There are primarily two types of contracts in the crude oil pipeline segment: (i) monthly transportation contracts and (ii) product sales contracts.

Under crude oil pipeline services monthly transportation contracts, customers submit nominations for transportation monthly and a contract is created upon the Partnership's acceptance of the nomination under its published tariffs. Crude oil pipeline services contracts have a single performance obligation to perform the transportation service. The transportation service is provided to the customer in the same month in which the customer makes the related nomination. Revenue is recorded in the month of service and invoiced in the following month. Payment is due within 30 days. The Partnership has elected to use the right-to-invoice expedient on crude oil pipeline services contracts as the right to consideration corresponds directly with the value to the customer of performance completed to date.

The Partnership also purchases crude oil and resells to third parties under written product sales contracts. Product sales contracts have a single performance obligation, and revenue is recognized at the point in time that control is transferred to the customer. Control is considered transferred to the customer on the day of the sale. Revenue is recorded in the month of service and invoiced in the following month. Payment is due within 30 days. The Partnership has elected to use the right-to-invoice expedient on product sales contracts as the right to consideration corresponds directly with the value to the customer of performance completed to date.

Services in the crude oil trucking segment are provided under master service agreements with customers that include rate sheets. Contracts are initiated when a customer requests service and both parties are committed upon the Partnership's acceptance of the customer's request. Crude oil trucking contracts have a single performance obligation to perform the service, which is completed in a day. Revenue is recorded in the month of service and invoiced in the following month. Payment is due within 30 days. The Partnership has elected to use the right-to-invoice expedient on crude oil trucking revenues as the right to consideration corresponds directly with the value to the customer of performance completed to date.

Disaggregation of Revenue

Disaggregation of revenue from contracts with customers for each operating segment by revenue type is presented as follows (in thousands):

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	Three Months ended September 30, 2018				
	Asphalt Terminal Services	Crude Oil Terminal Services	Crude Oil Pipeline Services	Crude Oil Trucking Services	Total
Third-party revenue:					
Fixed storage, throughput and other revenue	\$4,865	\$ 1,830	\$—	\$ —	\$6,695
Variable throughput revenue	112	93	—	—	205
Variable reimbursement revenue	1,943	—	—	—	1,943
Crude oil transportation revenue	—	—	1,166	2,734	3,900
Crude oil product sales revenue	—	—	97,763	—	97,763
Related-party revenue:					
Fixed storage, throughput and other revenue	3,011	—	83	—	3,094
Variable throughput revenue	762	—	—	—	762
Variable reimbursement revenue	1,439	—	101	—	1,540
Total revenue from contracts with customers	\$12,132	\$ 1,923	\$99,113	\$ 2,734	\$115,902

	Nine Months ended September 30, 2018				
	Asphalt Terminal Services	Crude Oil Terminal Services	Crude Oil Pipeline Services	Crude Oil Trucking Services	Total
Third-party revenue:					
Fixed storage, throughput and other revenue					