

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

KANEB SERVICES INC

CIK: **54441** | IRS No.: **751191271** | State of Incorporation: **DE** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **001-05083** | Film No.: **94527897**
SIC: **8711** Engineering services

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| | |
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KANEB SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(IN THOUSANDS - EXCEPT PER SHARE AMOUNTS)
(UNAUDITED)

<TABLE>
<CAPTION>

| | Three Months Ended March 31, | |
|--|---------------------------------|------------|
| | 1994 | 1993 |
| <S> | <C> | <C> |
| Revenues | \$50,687 | \$41,285 |
| Costs and expenses: | | |
| Operating costs | 39,581 | 33,771 |
| Depreciation and amortization | 3,047 | 2,461 |
| General and administrative expenses | 1,055 | 987 |
| Total costs and expenses | 43,683 | 37,219 |
| Operating income | 7,004 | 4,066 |
| Interest income and other income (expense) | 39 | (2) |
| Interest expense | (3,312) | (3,462) |
| Amortization of excess of cost over fair value of net assets of acquired business | (462) | (461) |
| Income from continuing operations before minority interest and income tax expense | 3,269 | 141 |
| Minority interest in net income | (3,121) | (1,951) |
| Income tax expense | (547) | (257) |
| Net loss | (399) | (2,067) |
| Dividends applicable to preferred stock | 354 | 373 |
| Net loss applicable to common stock | \$ (753) | \$ (2,440) |
| Loss per common share | \$ (.02) | \$ (.08) |
| Weighted average number of common shares outstanding | 32,322 | 31,777 |

</TABLE>

See Notes to Consolidated Financial Statements.

KANEB SERVICES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)
(UNAUDITED)

<TABLE>
<CAPTION>

| | March 31, 1994 | December 31, 1993 |
|--|-------------------|----------------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 16,615 | \$ 24,327 |
| Accounts receivable, trade | 28,968 | 27,300 |
| Inventories | 6,514 | 6,189 |
| Prepaid expenses and other current assets | 4,445 | 3,209 |
| | ----- | ----- |
| Total current assets | 56,542 | 61,025 |
| | ----- | ----- |
| Property and equipment | 238,128 | 234,368 |
| Less accumulated depreciation and amortization | 83,705 | 81,085 |
| | ----- | ----- |
| Net property and equipment | 154,423 | 153,283 |
| | ----- | ----- |
| Excess of cost over fair value of net assets | | |
| of acquired business | 68,260 | 68,722 |
| | ----- | ----- |
| Other assets | 5,034 | 4,442 |
| | ----- | ----- |
| | \$ 284,259 | \$ 287,472 |
| | ===== | ===== |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | 16,399 | 12,461 |
| Accounts payable | 9,292 | 10,414 |
| Accrued expenses | 21,376 | 18,313 |
| Accrued distribution payable | 3,980 | 3,995 |
| | ----- | ----- |
| Total current liabilities | 51,047 | 45,183 |
| | ----- | ----- |
| Long-term debt, less current portion | 144,264 | 152,678 |
| | ----- | ----- |
| Net liabilities of discontinued operations | 5,055 | 4,606 |
| | ----- | ----- |
| Deferred income taxes and other liabilities | 5,025 | 4,939 |
| | ----- | ----- |
| Minority interest | 64,365 | 65,205 |
| | ----- | ----- |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, without par value | 13,452 | 13,707 |
| Common stock, without par value | 4,223 | 4,222 |
| Additional paid-in capital | 201,711 | 201,976 |
| Accumulated deficit | (177,071) | (176,318) |
| Treasury stock, at cost | (28,255) | (28,755) |
| Cumulative foreign currency translation adjustment | 443 | 29 |
| | ----- | ----- |
| Total shareholders' equity | 14,503 | 14,861 |
| | ----- | ----- |
| | \$ 284,259 | \$ 287,472 |
| | ===== | ===== |

</TABLE>

See Notes to Consolidated Financial Statements.

KANEB SERVICES, INC. AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 THREE MONTHS ENDED MARCH 31, 1994 AND 1993
 (IN THOUSANDS)
 (UNAUDITED)

| | 1994 | 1993 |
|--|-----------|------------|
| | ----- | ----- |
| <S> | <C> | <C> |
| OPERATING ACTIVITIES: | | |
| Net loss | \$ (399) | \$ (2,067) |
| Adjustments to reconcile net loss to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,047 | 2,461 |
| Minority interest in net income | 3,121 | 1,951 |
| Amortization of excess of cost over fair value of net assets acquired | 462 | 461 |
| Deferred taxes | 244 | 146 |
| Changes in current assets and liabilities | (1,541) | 4,292 |
| | ----- | ----- |
| Net cash provided by operating activities | 4,934 | 7,244 |
| | ----- | ----- |
| INVESTING ACTIVITIES: | | |
| Capital expenditures | (4,450) | (2,036) |
| Acquisition of ST | - | (62,500) |
| Other | 152 | (664) |
| | ----- | ----- |
| Net cash used in investing activities | (4,298) | (65,200) |
| | ----- | ----- |
| FINANCING ACTIVITIES: | | |
| Issuance of long-term debt | 1,000 | 63,100 |
| Payments on long-term debt | (5,660) | (3,209) |
| Preferred stock dividends paid | (116) | (132) |
| Minority interest distributions | (4,021) | (2,814) |
| | ----- | ----- |
| Net cash provided by (used in) financing activities | (8,797) | 56,945 |
| | ----- | ----- |
| CASH PROVIDED BY DISCONTINUED OPERATIONS | 449 | 1,738 |
| | ----- | ----- |
| INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | (7,712) | 727 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 24,327 | 10,596 |
| | ----- | ----- |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | \$ 16,615 | \$ 11,323 |
| | ===== | ===== |
| SUPPLEMENTAL INFORMATION ON CASH PAID DURING THE PERIOD FOR: | | |
| Interest | \$ 2,577 | \$ 2,818 |
| | ===== | ===== |
| Income taxes | \$ 354 | \$ - |
| | ===== | ===== |

</TABLE>

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SIGNIFICANT ACCOUNTING POLICIES

The unaudited consolidated financial statements of Kaneb Services, Inc., and its subsidiaries (the "Company") for the periods ended March 31, 1994 and 1993 have been prepared in accordance with generally accepted accounting principles applied on a consistent basis. Significant accounting policies followed by the Company and its subsidiaries were disclosed in the notes to the financial statements included in the Company's Form 10-K Annual Report for the year ended December 31, 1993. In the opinion of the Company's management, the accompanying consolidated financial statements contain the adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position of the Company and its consolidated subsidiaries at March 31, 1994 and December 31, 1993 and the results of their operations and cash flows for the periods ended March 31, 1994 and 1993. Operating results for the three month period ended March 31, 1994 are not necessarily indicative of the results that may be expected for the year ended December 31, 1994.

2. CHANGE IN PRESENTATION

Certain financial statement items for 1993 have been restated to conform with the 1994 presentation.

3. COMMITMENTS AND CONTINGENCIES

In December 1987, a lawsuit was filed against the Company by Kanland Associates in the 240th District Court of Fort Bend County, Texas. Kanland, a Texas limited partnership, alleges that in January, 1987, the Company materially breached agreements with it, and as a consequence thereof Kanland defaulted on its obligations under a mortgage agreement relating to the Company's office building in Sugar Land, Texas, and on November 3, 1987, a foreclosure sale of the property was held, causing Kanland to suffer damages of an undetermined value. In February 1989, Kanland amended its petition against the Company to add a Company subsidiary, to expand its causes of action and to quantify its alleged damages at \$20 million. In January 1994, Kanland again amended its petition to add two more causes of action and to requantify its alleged damages at more than \$38 million plus pre-judgment interest, legal fees, court costs and punitive damages. On January 20, 1994, the court partially granted the Company's motion for summary judgment, dismissing three of Kanland's four original causes of action. A summary judgment hearing for the two causes of action added in January 1994 was heard on April 21, 1994. The court granted the Company's motion for summary judgment by dismissing both of Kanland's two additional causes of action. The Kanland suit is currently set for trial commencing on May 24, 1994. Also, in November 1989, Panance Property Corporation, an affiliate of Kanland's general partner, filed suit in a Harris County, Texas, district court against the Company and a subsidiary seeking damages for nonpayment by Kanland of a deferred fee note as a result of defendants' alleged breach of their agreements with Kanland. This case has been stayed pending the outcome of the Kanland suit. The Company continues to deny liability in the remaining claims under the Kanland case as well as the Panance suit and intends to vigorously defend these actions.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This discussion should be read in conjunction with the consolidated financial statements of Kaneb Services, Inc. and notes thereto included elsewhere in this report.

ANALYSIS OF SEGMENT OPERATIONS:

INDUSTRIAL SERVICES

<TABLE>
<CAPTION>

| | Three Months Ended March 31, | |
|--------------------------------|---------------------------------|---------|
| | 1994 | 1993 |
| | (In millions) | |
| <S> | <C> | <C> |
| Revenues | \$ 28.9 | \$ 26.3 |
| Operating income (loss): | | |
| United States | \$.9 | \$.3 |
| United Kingdom | - | (.2) |
| Germany | (.6) | .4 |
| Other | .2 | (.2) |
| Capital expenditures | \$.6 | \$.1 |

</TABLE>

This segment provides specialized industrial services to plants primarily in the process and power industry. The US and UK operations reported improvement in 1994 over the comparable period in 1993. Although the privatization projects in eastern Germany have provided profits over the past two years, there has been a substantial decline in the amount of work being performed at these locations. The Company believes that this decline is the result of high unemployment and over capacity in the power industry in the eastern part of Germany. The Company expects this segment to continue to improve, but the improvement will not be significant until these German projects have returned to profitability.

The \$.2 million other operating loss in 1993 includes the operations in France and Spain. The operation in Spain was closed in the summer of 1993 and the French operation was at breakeven for the first quarter of 1994 as compared to a \$.2 million operating loss in the first quarter of 1993.

PIPELINE AND TERMINALING SERVICES

<TABLE>
<CAPTION>

| | Three Months Ended March 31, | | |
|--------------------------------|---------------------------------|-------------|--------------|
| | 1994 | 1993 | 1993 |
| | | (Pro forma) | (Historical) |
| <S> | <C> | <C> | <C> |
| Revenues | \$ 18.4 | \$ 16.9 | \$ 12.1 |
| Operating income | \$ 7.2 | \$ 6.0 | 4.8 |
| Capital expenditures | \$ 3.9 | \$ 2.2 | 1.9 |

</TABLE>

This segment provides transportation services of refined petroleum products through its pipeline system that extends from Kansas to North Dakota. Additionally, this segment provides terminaling services for petroleum

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products and specialty liquids at its 21 terminals. The terminaling operation was acquired effective March 1, 1993.

The increase in the first quarter over the 1993 pro forma results in both revenues and operating income is due to a 8% increase in long-haul barrels delivered on the pipeline system and a increase of 8% of the average rate per barrel stored at the terminaling operation.

OTHER OPERATIONS

The Company recorded operating income of \$.3 million in the first three months of 1994 compared to breakeven for the same period in 1993 related to subsidiaries that provide information services to financial and retail customers. The increase in minority interest expense in 1994 as compared to 1993 is attributable to the 2.25 million senior preference units that were issued in April 1993 by the Partnership.

FINANCIAL CONDITION

Cash and cash equivalents was \$16.6 million at March 31, 1994, a decrease of \$7.7 million from \$24.3 million at December 31, 1993. Net cash provided by operations of \$4.9 million was offset by \$4.4 million of capital expenditures and net payments on long- term debt of \$4.6 million and distributions to minority interest owners of KPP of \$4.0 million. The increase of \$1.2 million in minority interest distributions from the first quarter of 1993 represents the fourth quarter 1993 distribution on the 2.25 million partnership units that were issued by the Partnership in April, 1993.

The Partnership reclassified \$10 million of its term loan to current at March 31, 1994. The Partnership is currently evaluating alternative methods of refinancing this obligation and expects to have the refinancing completed prior to December 31, 1994.

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SIGNATURE

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.

KANEB SERVICES, INC.
(Registrant)

Date: May 13, 1994

/s/ Tony M. Regan
Tony M. Regan
Controller

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