SUNOCO INC
Form 10-Q
November 01, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended 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 1-6841

SUNOCO, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	**23-1743282**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

1735 MARKET STREET, SUITE LL, PHILADELPHIA, PA 19103-7583

(Address of principal executive offices)

(Zip Code)

(215) 977-3000

(Registrant s telephone number, including area code)

NOT APPLICABLE

(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 x NO ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act (Check One):

Large accelerated filer x 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 x

At September 30, 2007, there were 117,582,200 shares of Common Stock, $1 par value outstanding.

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PART I.

FINANCIAL INFORMATION

Item 1. Financial Statements (Unaudited)
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Sunoco, Inc. and Subsidiaries

(Millions of Dollars and Shares, Except Per-Share Amounts)

	For the Nine Months Ended September 30	
	2007	2006
	(UNAUDITED)	
REVENUES		
Sales and other operating revenue (including consumer excise taxes)	$ 31,334	$ 29,624
Interest income	16	29
Other income, net (Notes 2 and 3)	216	26
	31,566	29,679
COSTS AND EXPENSES		
Cost of products sold and operating expenses	26,931	25,179
Consumer excise taxes	1,983	1,970
Selling, general and administrative expenses (Note 2)	678	635
Depreciation, depletion and amortization	355	341
Payroll, property and other taxes	103	98
Interest cost and debt expense	96	78
Interest capitalized	(19)	(10)
	30,127	28,291
Income before income tax expense	1,439	1,388
Income tax expense (Note 4)	539	532
NET INCOME	$ 900	$ 856
Earnings per share of common stock:		
Basic	$ 7.48	$ 6.56
Diluted	$ 7.46	$ 6.53
Weighted-average number of shares outstanding (Notes 5 and 9):		
Basic	120.4	130.4
Diluted	120.7	131.1
Cash dividends paid per share of common stock (Note 9)	$ .80	$ .70

(See Accompanying Notes)

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Sunoco, Inc. and Subsidiaries

(Millions of Dollars and Shares, Except Per-Share Amounts)

	For the Three Months Ended September 30	
	2007	2006
	(UNAUDITED)	
REVENUES		
Sales and other operating revenue (including consumer excise taxes)	$ 11,475	$ 10,480
Interest income	7	11
Other income, net (Notes 2 and 3)	15	5
	11,497	10,496
COSTS AND EXPENSES		
Cost of products sold and operating expenses	10,078	8,867
Consumer excise taxes	673	679
Selling, general and administrative expenses (Note 2)	221	215
Depreciation, depletion and amortization	123	115
Payroll, property and other taxes	36	33
Interest cost and debt expense	29	25
Interest capitalized	(5)	(5)
	11,155	9,929
Income before income tax expense	342	567
Income tax expense (Note 4)	126	216
NET INCOME	$ 216	$ 351
Earnings per share of common stock:		
Basic	$ 1.82	$ 2.77
Diluted	$ 1.81	$ 2.76
Weighted-average number of shares outstanding (Notes 5 and 9):		
Basic	119.0	126.8
Diluted	119.2	127.4
Cash dividends paid per share of common stock (Note 9)	$ .275	$ .25

(See Accompanying Notes)

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CONDENSED CONSOLIDATED BALANCE SHEETS

Sunoco, Inc. and Subsidiaries

(Millions of Dollars)

	At September 30 2007 (UNAUDITED)	At December 31 2006
ASSETS		
Current Assets		
Cash and cash equivalents	$ 263	$ 263
Accounts and notes receivable, net	2,625	2,440
Inventories:		
Crude oil	555	325
Petroleum and chemical products	731	735
Materials, supplies and other	159	159
Deferred income taxes (Note 4)	93	93
Total Current Assets	4,426	4,015
Investments and long-term receivables	134	129
Properties, plants and equipment	11,272	10,540
Less accumulated depreciation, depletion and amortization	4,393	4,175
Properties, plants and equipment, net	6,879	6,365
Deferred charges and other assets	567	473
Total Assets	$ 12,006	$ 10,982
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 4,157	$ 3,615
Accrued liabilities (Note 6)	508	559
Short-term borrowings	250	275
Current portion of long-term debt	4	7
Taxes payable	277	299
Total Current Liabilities	5,196	4,755
Long-term debt	1,785	1,705
Retirement benefit liabilities (Note 8)	529	523
Deferred income taxes (Note 4)	955	829
Other deferred credits and liabilities (Note 6)	530	477
Commitments and contingent liabilities (Note 6)		
Minority interests (Note 2)	445	618
Shareholders equity (Note 9)	2,566	2,075
Total Liabilities and Shareholders Equity	$ 12,006	$ 10,982

(See Accompanying Notes)

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Sunoco, Inc. and Subsidiaries

(Millions of Dollars)

	For the Nine Months Ended September 30	
	2007	2006
	(UNAUDITED)	
INCREASES (DECREASES) IN CASH AND CASH EQUIVALENTS		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 900	$ 856
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain related to issuance of Sunoco Logistics Partners L.P. limited partnership units (Note 2)	(151)	
Phenol supply contract dispute payment (Note 3)		(95)
Depreciation, depletion and amortization	355	341
Deferred income tax expense	153	74
Payments in excess of expense for retirement plans	(49)	(50)
Changes in working capital pertaining to operating activities, net of effect of acquisitions:		
Accounts and notes receivable	(253)	(462)
Inventories	(226)	(480)
Accounts payable and accrued liabilities	495	513
Taxes payable	7	33
Other	26	2
Net cash provided by operating activities	1,257	732
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(876)	(675)
Acquisitions (Note 3)		(123)
Proceeds from divestments (Note 3)	46	39
Other	(30)	4
Net cash used in investing activities	(860)	(755)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from (repayments of) short-term borrowings	(25)	150
Net proceeds from issuance of long-term debt	244	361
Repayments of long-term debt	(167)	(426)
Net proceeds from issuance of Sunoco Logistics Partners L.P. limited partnership units (Note 2)		110
Cash distributions to investors in cokemaking operations	(19)	(13)
Cash distributions to investors in Sunoco Logistics Partners L.P.	(41)	(35)
Cash dividend payments	(97)	(92)
Purchases of common stock for treasury	(300)	(734)
Proceeds from issuance of common stock under management incentive plans	6	1
Other	2	
Net cash used in financing activities	(397)	(678)
Net decrease in cash and cash equivalents		(701)
Cash and cash equivalents at beginning of period	263	919

Cash and cash equivalents at end of period	$ 263	$ 218

(See Accompanying Notes)

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. General.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and U.S. generally accepted accounting principles for interim financial reporting. They do not include all disclosures normally made in financial statements contained in Form 10-K. In management s opinion, all adjustments necessary for a fair presentation of the results of operations, financial position and cash flows for the periods shown have been made. All such adjustments are of a normal recurring nature, except for the gain related to Sunoco Logistics Partners L.P. s prior issuance of limited partnership units, the charge related to the correction of an error in the computation of the preferential return of third-party investors in Sunoco s cokemaking operations and gains related to income tax matters (Notes 2 and 4). Results for the three and nine months ended September 30, 2007 are not necessarily indicative of results for the full-year 2007.

2. Minority Interests.

Cokemaking Operations

Sunoco received a total of $309 million in exchange for interests in its Jewell cokemaking operations in two separate transactions in 1995 and 2000. Sunoco also received a total of $415 million in exchange for interests in its Indiana Harbor cokemaking operations in two separate transactions in 1998 and 2002. Sunoco did not recognize any gain as of the dates of these transactions because the third-party investors were entitled to a preferential return on their respective investments.

In December 2006, Sunoco acquired the limited partnership interest of the third-party investor in the Jewell cokemaking operation for $155 million. As a result, such third-party investor is no longer entitled to any preferential or residual return in this operation.

The returns of the investors in the Indiana Harbor cokemaking operations are currently equal to 98 percent of the cash flows and tax benefits from such cokemaking operations during the preferential return period, which continues until the investor entitled to the preferential return recovers its investment and achieves a cumulative annual after-tax return of approximately 10 percent. The preferential return period for the Indiana Harbor operations is projected to end no later than the first quarter of 2008. The accuracy of this estimate is somewhat uncertain as the length of the preferential return period is dependent upon estimated future cash flows as well as projected tax benefits which could be impacted by their potential phase-out (see below). Lower-than-expected cash flows and tax benefits could lengthen the investor s preferential return period. After payment of the preferential return, the investors in the Indiana Harbor operations will be entitled to a minority interest in the related cash flows and tax benefits initially amounting to 34 percent and thereafter declining to 10 percent by 2038.

Under existing tax law, most of the coke production at Jewell and all of the production at Indiana Harbor are not eligible to generate nonconventional fuel tax credits after 2007. In addition, during 2007 such credits would be phased out, on a ratable basis, if the average annual price of domestic crude oil at the wellhead is within a certain inflation-adjusted price range. (This range was $55.06 to $69.12 per barrel for 2006, the latest year for which the range is available.) The domestic wellhead price averaged $59.21 per barrel for the eight months ended August 31, 2007, $67.78 per barrel for the month of August 2007 and $59.69 per barrel for the year ended December 31, 2006. The corresponding prices for West Texas Intermediate

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(WTI) crude oil, a widely published reference price for domestic crude oil, were $64.55 per barrel for the eight months ended August 31, 2007, $72.36 per barrel for the month of August 2007 and $66.22 per barrel for the year ended December 31, 2006. Based upon the Company s estimate of domestic wellhead prices for the first nine months of 2007, the Company recorded 70 percent of the benefit of the tax credits that otherwise would have been available without regard to these phase-out provisions. The estimated impact of this phase-out reduced earnings for the first nine months of 2007 by $6 million after tax. During the first nine months of 2006, a partial phase-out of the tax credits resulting from the high level of crude oil prices reduced earnings by $10 million after tax during that period. The ultimate amount of the credits to be earned for 2007 will be based upon the average annual price of domestic crude oil at the wellhead.

The Company indemnifies the third-party investors (including the former investor in the Jewell cokemaking operations) for certain tax benefits available to them during the preferential return period in the event the Internal Revenue Service disallows the tax deductions and benefits allocated to the third parties or if there is a change in the tax laws that reduces the amount of nonconventional fuel tax credits. These tax indemnifications are in effect until the applicable tax returns are no longer subject to Internal Revenue Service review. In certain of these cases, if performance under the indemnification is required, the Company also has the option to purchase the remaining third-party investors interests. Although the Company believes the possibility is remote that it will be required to do so, at September 30, 2007, the maximum potential payment under these tax indemnifications would have been approximately $280 million.

The following table sets forth the minority interest balances and the changes in these balances attributable to the third-party investors interests in cokemaking operations (in millions of dollars):