

Sunoco, LP

NYSE:SUN

Analyst: Kyle Ritchie

Sector: Energy

BUY on SUN

Price Target: \$ 43.95

Key Statistics as of 4/27/16

Market Price:	\$36.60
Industry:	Oil and Gas Storage/Transportation
Market Cap:	\$3.8 billion
52-Week Range:	\$22.86– \$54.82
Unlevered Beta:	.85
Trading Volume:	380,000

Thesis Points:

- Exponential revenue growth that continues to beat analyst expectations
- Strategic acquisitions and dropdowns that have resulted in expanding margins
- ROIC/WACC ratio proves value creation

Company Description

Sunoco L.P. is a growth-oriented MLP and distributor of Sunoco-branded motor fuel to convenience stores, independent dealers, commercial customers and distributors. The company engages in the wholesale distribution and retail sale of motor fuels primarily in Texas, New Mexico, Oklahoma, Louisiana, Kansas, Maryland, Virginia, Tennessee, Georgia, and Hawaii. The company also distributes other petroleum products such as propane and lubricating oils; and leases or subleases real estate properties used in the retail distribution of motor fuels. The company is headquartered in Houston, Texas.



Thesis

Sunoco LP is a well-established leading competitor in the oil and gas industry. Of the seventeen analysts covering SUN, the median target of free cash flow for 2016 is 170 million, compared to the 17.3 million generated in 2015. This is due to a number of reasons. Through strategic acquisitions Sunoco has generated substantial revenue growth and furthermore, has notably expanded margins. The price of crude oil as well as the market downturn in 2015 had a major impact on the company's stock price. Nevertheless, a reversion of this company's stock price to the increasing trend, which can be seen in the chart below, can be expected in the upcoming months. Lastly, the company's return on invested capital compared to its weighted average cost of capital proves significant value creation to shareholders. For the aforementioned reasons I am recommending a BUY on SUN.

Industry Outlook



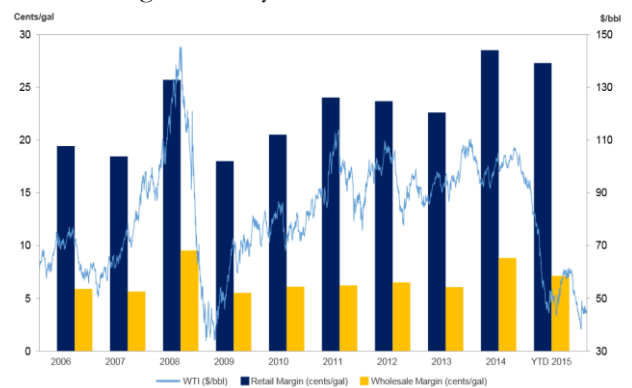
As you can see from the preceding graph that dates back to the start of 2013, Sunoco's stock price started around \$25/share and reached \$55 prior to the market's downturn. Since the market's downturn, the company's stock price has reverted to around \$35/share. What will continue to impact SUN more drastically than the market as a whole is the price of crude oil. As you can see from the following 1-year graph of crude oil prices, the cost per barrel has begun to increase again.



The takeaway here is that Sunoco has managed to sustain notable revenue growth during a time of extremely volatile commodity pricing. As the price of crude oil continues to increase (or at least remain fluctuating at current levels), Sunoco's revenue will increase further. The Economy Forecast Agency (EFA) is an agency that specializes on long-range financial market forecasts for corporate clients. This agency's historical forecasts for the price of crude oil have been very accurate. The agency provides monthly expectations in the price of crude oil which include highs, lows and averages. For 2016 into 2017, the monthly averages amount to \$48/barrel.

Exponential Revenue Growth

During a time of extreme volatility in the price of crude oil, SUN was still able to have a strong quarter performance. Both adjusted EBITDA and cash flow attributable to partners had significant increases compared to last year's respective quarter. SUN's total volume of gallons sold increased 39% from last year to 408 million gallons. The gross profit on these gallons was \$0.082/gallon, a notable increase from \$0.049/gallon last year.



As you can see from the chart above the company's margins were only slightly impacted when the price of crude oil dropped from \$100 to \$40/barrel.

This chart ultimately reflects the company's wholesale and retail margins resilience through commodity cycles.

Coupled with the gross margin increase, the company's retail segment had a strong performance as well. Same store sales volume increased by 1.3%.

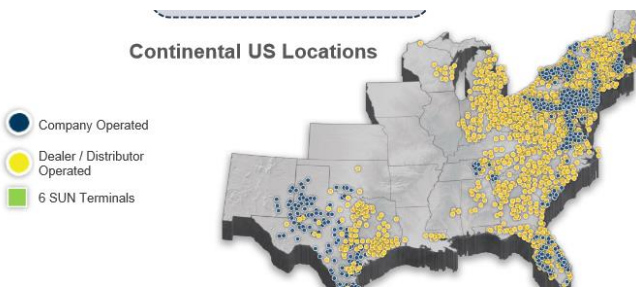
It is clear that this surprise has carried over to analyst estimates as well. The chart below reflects the revenue and EBITDA surprises for the past five quarters.

Quarter ending	Past Earning Surprises	
	Revenue	EBITDA
12/31/2014	257.38%	149.90%
3/31/2015	165.93%	5.69%
6/30/2015	8.48%	175.08%
9/30/2015	-14.09%	37.39%
12/31/2015	28.82%	15.26%
Mean	76.57%	69.96%
Standard error	57.4%	39.0%

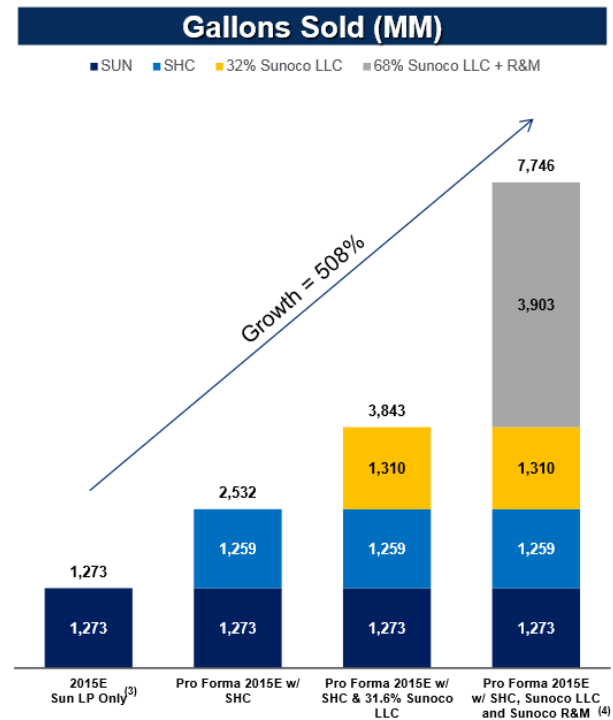
An appealing feature to investors is when the street continues to underestimate a company's performance while the stock price has yet to react. Sunoco beat its revenue three out of the last five quarters by an average of more than 130%. The company beat its EBITDA expectations four out of the last five quarters from Q4 of 2014 – Q4 2015 by 149%, 6%, 175%, and 38% respectively. The consistent positive EBITDA surprises proves the company's ability to efficiently manage operating costs while continuing to grow exponentially.

Strategic Acquisitions/Company Dropdown Transactions

To reiterate, the same store sales increase of 1.3% was largely influenced by the recently acquired Mid-Atlantic Convenience Stores (MACS). During the same period, MACS experienced an increase of 7.1% in merchandise sales. This successful acquisition continues to extend the company's geographic reach which can be seen in the chart below.



Recently, Sunoco has been engaging in multiple drop down transactions. The purpose of this strategy is to acquire additional investors without these investors being directly involved in their main business. Previously acquired assets are being sold to themselves in order to spread the risk of a new venture among several entities. The following chart shows the impact of this company's vertical integration which can be considered organic growth as these were originally Sunoco entities.



Based on these figures, the number of gallons sold will grow by 508% in 2015. The following table shows how this company's strategy has impacted its total reported margins.

ttf Revenue, Adj	2,994.2	2,091.5	2,663.8	3,800.4	4,221.4	4,892.6	10,317.5	16,925.2	16,925.2
ttf Growth % YoY	47.7	-27.9	28.2	42.4	13.1	4.0	129.7	64.1	64.1
ttf Gross Profit, Adj	38.0	32.3	36.1	36.9	41.5	62.3	371.0	1,456.2	1,456.2
ttf Margin %	1.3	1.5	1.3	1.0	1.0	1.3	3.6	8.6	8.6
ttf EBITDA, Adj	-	18.4	19.6	23.3	30.8	49.9	118.4	521.3	521.3
ttf Margin %	-	0.9	0.7	0.6	0.7	1.1	1.1	3.1	3.1
ttf Net Income, Adj	12.2	8.5	9.2	10.6	9.2	37.0	56.7	89.8	102.5
ttf Margin %	0.4	0.4	0.3	0.3	0.2	0.8	0.5	0.5	0.6

Most notably, the gross margin has increased from 1.4% in 2013 to 8.6% in 2015. The EBITDA margin increased by approximately 300 basis points.

ROIC/WACC ~ Value Creation

An important figure to look at when analyzing a company is its return on invested capital (ROIC). But more importantly, the ROIC/WACC ratio. This figure demonstrates that a company is yielding a higher return rate on its capital expenditures than it pays to run the

business. When this ratio is greater than 1 (after adjustments for goodwill and such forth) value is being created for the shareholders. As you can see from the table below, Sunoco has certainly proven value creation. The 5-year average is approximately 9.

ROIC	10.1%	10.1%	6.5%	17.7%	307.8%	6.3%
WACC	10.1%	10.1%	3.1%	4.9%	6.8%	8.7%
ROIC/WACC	1.00	1.00	2.11	3.65	45.47	0.72
					5-Year Avg.	8.99

Valuation

The valuation of Sunoco LP is based on a valuation computed by a pro forma using a DCF method with a main focus on return on invested capital.

Attached to this report is an overview containing the assumptions, inputs, and significant market data that have been used in the valuation.

When valuing Sunoco LP, a moderate approach has been applied. Due to the nature of the business, a 10 year period to convergence has been used. The pro forma has used the average of analysts' estimates for revenue growth in the upcoming years. Since Sunoco operates solely in the United States, a tax rate of 40% has been applied along with a discount rate (risk premium) of 6.00 %.

The financial metrics of the firm were made to converge closely with the industry averages that have been provided by Capital IQ which include total operating costs as a percentage of revenue, revenue, beta, and the D/E level. In 2015, Sunoco's adjusted operating costs/revenue was 96.9%. The average operating costs/revenue for the industry is 64.8% and its historical average is 96%.

Inputting the aforementioned assumptions and inputs, the pro forma calculated an intrinsic value of \$42.05 compared to its market price of \$36.60 with a one-year target of \$43.95.

Conclusion

In conclusion I am recommending a BUY on Sunoco. Given the industry outlook which will be the primary determinant of this company's stock price along with its strong performance during volatile oil pricing. It is clear that this company can sustain long-term growth and yield a potential 30% return for investors.

Sunoco LP (SUN)

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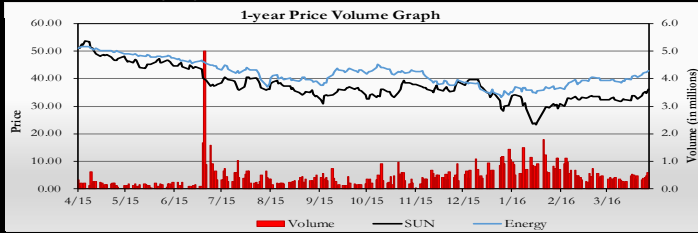
BULLISH

Analysis by P.C. Principal
4/29/2016

Current Price: **\$36.61**
Dividend Yield: **9.9%**

Intrinsic Value: **\$42.05**
Target Price: **\$43.95**

Target 1 year Return: **29.98%**
Probability of Price Increase: **82%**



Description	
Sunoco LP engages in the wholesale distribution and retail sale of motor fuels primarily in Texas, New Mexico, Oklahoma, Louisiana, Kansas, Maryland, Virginia, Tennessee, Georgia, and Hawaii.	
General Information	
Sector	Energy
Industry	Oil, Gas and Consumable Fuels
Last Guidance	November 3, 2015
Next earnings date	May 5, 2016
Estimated Country Risk Premium	6.00%
Effective Tax rate	40%
Effective Operating Tax rate	26%

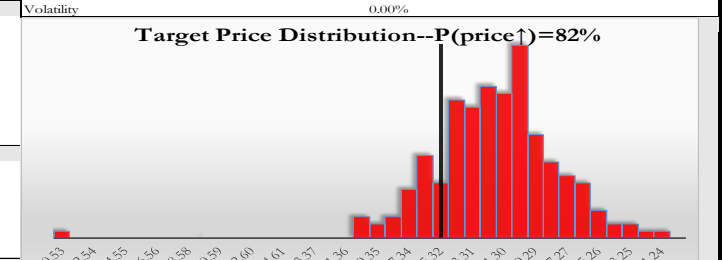
Market Data	
Market Capitalization	\$4,012.96
Daily volume (mil)	0.38
Shares outstanding (mil)	111.75
Diluted shares outstanding (mil)	98.38
% shares held by institutions	78%
% shares held by investments Managers	47%
% shares held by hedge funds	2%
% shares held by insiders	0.03%
Short interest	5.26%
Days to cover short interest	9.57
52 week high	\$54.82
52-week low	\$22.86
Levered Beta	1.18
Volatility	0.00%

Past Earning Surprises		
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Peers	
Sunoco Logistics Partners L.P.	
Global Partners LP	
Murphy USA Inc.	
CrossAmerica Partners LP	
Plains All American Pipeline, L.P.	
NGL Energy Partners LP	
CST Brands, Inc.	
Kinder Morgan, Inc.	

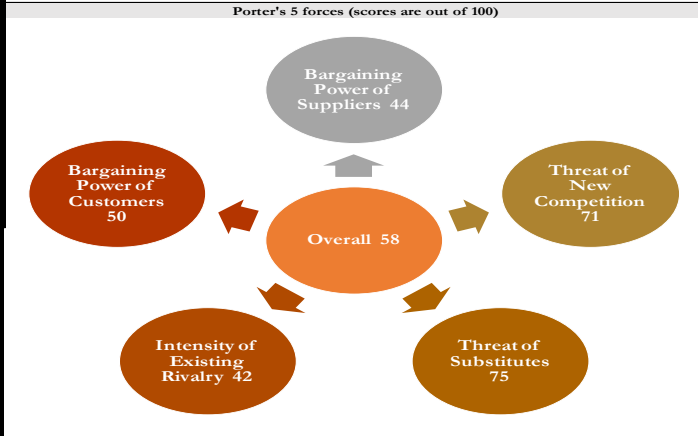
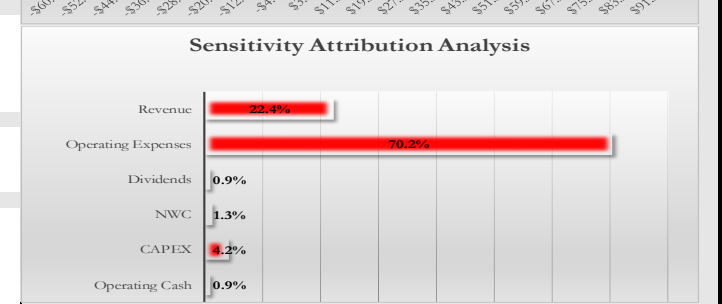
Management	
Owens, Robert	Chief Executive Officer of S
Archer, Cynthia	Chief Marketing Officer of S
Curia, Christopher	Executive Vice President of
Heinemann, S.	Executive Vice President of
Williams, R.	Executive Vice President of
Grieschow, Scott	Director of Investor Relatio

Total compensations growth		Total return to shareholders	
124.46% per annum over 1y		-14.42% per annum over 1y	
N/M		N/M	
N/M		N/M	
N/M		N/M	
N/M		N/M	
N/M		N/M	



Profitability		SUN (LTM)		SUN (5 years historical average)		Industry (LTM)	
ROIC	6.3%	70.45%		-0.10%			
NOPAT Margin	2%	1.82%		-5.4%			
Revenue/Invested Capital	3.25	38.66		0.02			
ROE	7.1%	78.99%		-1.56%			
Adjusted net margin	2%	1.79%		-11.6%			
Revenue/Adjusted Book Value	4.37	44.21		0.13			

Invested Funds		SUN (LTM)		SUN (5 years historical average)		Industry (LTM)	
Total Cash/Total Capital	1.1%	1.8%		7%			
Estimated Operating Cash/Total Capital	1.1%	1.2%		N/A			
Non-cash working Capital/Total Capital	5.1%	6.6%		0%			
Invested Capital/Total Capital	100.4%	98.1%		89%			



Capital Structure		SUN (LTM)		SUN (5 years historical average)		Industry (LTM)	
Total Debt/Common Equity (LTM)	0.69	0.32		0.55			
Cost of Existing Debt	8.14%	3.48%		4.29%			
Estimated Cost of new Borrowing	3.77%	2.10%		4.29%			
CGIS Risk Rating	BB	A		CC			
Unlevered Beta (LTM)	0.85	0.41		1.15			
WACC	8.70%	7.00%		10.44%			

Valuation	
Period	Revenue growth
Base Year	64.1%
12/31/2016	10.0%
12/31/2017	8.0%
12/31/2018	7.0%
12/31/2019	6.0%
12/31/2020	5.0%
12/31/2021	4.0%
12/31/2022	3.0%
12/31/2023	3.0%
12/31/2024	2.5%
12/31/2025	2.0%
Continuing Period	2.1%

Invested Capital		Net Claims	
Base Year	\$116.50	\$2,057.92	
12/31/2016	\$125.96	\$3,017.74	\$44.90
12/31/2017	\$139.74	\$3,557.88	\$46.84
12/31/2018	\$260.98	\$4,009.96	\$50.80
12/31/2019	\$5,216.10	\$4,848.92	\$53.21
12/31/2020	\$5,584.26	\$5,622.20	\$56.29
12/31/2021	\$6,573.06	\$6,215.49	\$60.12
12/31/2022	\$7,104.91	\$6,608.78	\$64.72
12/31/2023	\$7,603.09	\$6,821.03	\$70.08
12/31/2024	\$8,060.37	\$6,838.29	\$76.18
12/31/2025	\$8,432.83	\$6,753.30	\$83.00
Continuing Period			

NOPAT margin		ROIC/WACC	
Base Year	1.9%		0.72
12/31/2016	2.0%		0.81
12/31/2017	2.2%		0.81
12/31/2018	2.5%		0.90
12/31/2019	0.7%		0.24
12/31/2020	0.8%		0.26
12/31/2021	1.4%		0.47
12/31/2022	2.1%		0.68
12/31/2023	2.8%		0.87
12/31/2024	3.4%		1.06
12/31/2025	4.1%		1.23
Continuing Period	4.7%		1.39