SUNOCO LOGISTICS PARTNERS LP
Form 10-Q
May 02, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

OR

o **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 1-31219
SUNOCO LOGISTICS PARTNERS L.P.
(Exact name of registrant as specified in its charter)

Delaware	**23-3096839**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
Mellon Bank Center	
1735 Market Street, Suite LL, Philadelphia, PA	**19103-7583**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (866) 248-4344
Former name, former address and formal fiscal year, if changed since last report: Not Applicable

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 þ No o
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.:

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
At May 2, 2007, the number of the registrant s Common Units outstanding was 28,586,280.

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PART I
FINANCIAL INFORMATION

Item 1. Financial Statements

SUNOCO LOGISTICS PARTNERS L.P.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(in thousands, except unit and per unit amounts)

	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Revenues		
Sales and other operating revenue:		
Affiliates (Note 3)	$ 452,069	$ 478,321
Unaffiliated customers	1,097,501	782,650
Other income	5,039	2,391
Total Revenues	1,554,609	1,263,362
Costs and Expenses		
Cost of products sold and operating expenses	1,499,258	1,214,786
Depreciation and amortization	8,904	8,946
Selling, general and administrative expenses	15,519	15,003
Total Costs and Expenses	1,523,681	1,238,735
Operating Income	30,928	24,627
Net interest cost paid to affiliates (Note 3)	535	309
Other interest cost and debt expense, net	8,639	6,450
Capitalized interest	(553)	(556)
Net Income	$ 22,307	$ 18,424
Calculation of Limited Partners interest in Net Income (Note 4):		
Net Income	$ 22,307	$ 18,424
Less: General Partner s interest in Net Income	(2,079)	(1,344)
Limited Partners interest in Net Income	$ 20,228	$ 17,080
Net Income per Limited Partner unit:		
Basic	$ 0.71	$ 0.66
Diluted	$ 0.70	$ 0.66

Weighted average Limited Partners units outstanding (Note 4):		
Basic	28,564,996	25,819,210
Diluted	28,702,728	25,944,752

(See Accompanying Notes)

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SUNOCO LOGISTICS PARTNERS L.P.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31, 2007	December 31, 2006
	(UNAUDITED)	
Assets		
Current Assets		
Cash and cash equivalents	$	$ 9,412
Advances to affiliates (Note 3)		7,431
Accounts receivable, affiliated companies (Note 3)	153,281	98,952
Accounts receivable, net	756,029	776,505
Inventories:		
Crude oil	81,424	69,552
Materials, supplies and other	731	732
Total Current Assets	991,465	962,584
Properties, plants and equipment	1,524,033	1,506,350
Less accumulated depreciation and amortization	(508,382)	(499,682)
Properties, plants and equipment, net	1,015,651	1,006,668
Investment in affiliates (Note 5)	81,299	81,934
Deferred charges and other assets	26,797	30,891
Total Assets	$ 2,115,212	$ 2,082,077
Liabilities and Partners Capital		
Current Liabilities		
Accounts payable	$ 923,029	$ 922,495
Accrued liabilities	22,432	34,843
Accrued taxes other than income	16,663	22,869
Advances from affiliates (Note 3)	7,676	
Total Current Liabilities	969,800	980,207
Long-term debt (Note 6)	539,959	491,910
Other deferred credits and liabilities	26,789	27,049
Commitments and contingent liabilities (Note 7)		
Total Liabilities	1,536,548	1,499,166
Partners Capital:		
Limited partners interest	574,675	576,004
General partner s interest	3,989	6,907

Total Partners Capital	578,664	582,911
Total Liabilities and Partners Capital	$ 2,115,212	$ 2,082,077

(See Accompanying Notes)

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SUNOCO LOGISTICS PARTNERS L.P.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(in thousands)

	Three Months Ended March 31, 2007	2006
Cash Flows from Operating Activities:		
Net Income	$ 22,307	$ 18,424
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,904	8,946
Restricted unit incentive plan expense	2,256	806
Changes in working capital pertaining to operating activities net of the effect of acquisitions:		
Accounts receivable, affiliated companies	(54,329)	7,380
Accounts receivable, net	20,476	(85,330)
Inventories	(11,871)	(18,853)
Accounts payable and accrued liabilities	(12,079)	114,155
Accrued taxes other than income	(6,206)	(3,307)
Other	4,925	(3,443)
Net cash provided by operating activities	(25,617)	38,778
Cash Flows from Investing Activities:		
Capital expenditures	(17,881)	(18,228)
Acquisitions		(109,448)
Net cash used in investing activities	(17,881)	(127,676)
Cash Flows from Financing Activities:		
Distributions paid to Limited Partners and General Partner	(28,253)	(20,360)
Payments of statutory withholding on net issuance of Limited Partner units under restricted unit incentive plan	(1,479)	(1,443)
Contributions from General Partner for Limited Partner unit transactions	58	74
Repayments from (advances to) affiliates, net	15,107	(15,567)
Borrowings under credit facility	48,000	109,500
Contributions from / (Distributions to) affiliate	653	
Net cash provided by financing activities	34,086	72,204
Net change in cash and cash equivalents	(9,412)	(16,694)
Cash and cash equivalents at beginning of year	9,412	21,645
Cash and cash equivalents at end of period	$	$ 4,951

(See Accompanying Notes)

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SUNOCO LOGISTICS PARTNERS L.P.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. Basis of Presentation

Sunoco Logistics Partners L.P. (the Partnership) is a publicly traded Delaware limited partnership formed by Sunoco, Inc. (Sunoco) in October 2001 to acquire a substantial portion of Sunoco s logistics business. The Partnership owns and operates a geographically diverse portfolio of complementary assets, consisting of refined product pipelines, terminalling and storage assets, crude oil pipelines, and crude oil acquisition and marketing assets located in the Northeast, Midwest and South Central United States. Sunoco, Inc. and its wholly owned subsidiaries including Sunoco, Inc. (R&M) are collectively referred to as Sunoco .

The consolidated financial statements reflect the results of Sunoco Logistics Partners L.P. and its wholly-owned partnerships, including Sunoco Logistics Partners Operations L.P. (the Operating Partnership). Equity ownership interests in corporate joint ventures, which are not consolidated, are accounted for under the equity method.

The accompanying condensed consolidated financial statements are presented in accordance with the requirements of Form 10-Q and accounting principles generally accepted in the United States 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. Results for the three months ended March 31, 2007 are not necessarily indicative of results for the full year 2007.

2. Acquisitions

Mid-Valley Pipeline Acquisition

On August 18, 2006, the Partnership purchased from Sunoco a 100 percent interest in Sun Pipe Line Company of Delaware LLC, the owner of a 55.3 percent equity interest (50 percent voting rights) in Mid-Valley Pipeline Company (Mid-Valley) for approximately $65 million, subject to certain adjustments five years following the date of closing, based on the throughput of Sunoco. Mid-Valley owns a 994-mile pipeline, which originates in Longview, Texas and terminates in Samaria, Michigan, and has operating capacity of approximately 238,000 bpd and 4.2 million shell barrels of storage capacity. Mid-Valley provides crude oil to a number of refineries, primarily in the Midwest United States. The Partnership is the operator of the Mid-Valley pipeline. The Partnership receives a quarterly cash dividend from Mid-Valley that is proportionate with its ownership interest. The purchase price of the acquisition was funded with $46.0 million in borrowings under the Partnership s Credit Facility and with cash on hand. Since the acquisition was from a related party, the interest in the entity was recorded by the Partnership at Sunoco s historical cost of approximately $12.5 million and the $52.5 million difference between the purchase price and the cost basis of the assets was recorded by the Partnership as a capital distribution. The results of the acquisition are included in the financial statements within the Western Pipeline System business segment from the date of acquisition.

Millennium and Kilgore Pipeline Acquisition

On March 1, 2006, the Partnership purchased a Texas crude oil pipeline system from affiliates of Black Hills Energy, Inc. for approximately $40.9 million. The system consists of (a) the Millennium Pipeline, a 200-mile, 12-inch crude oil pipeline with approximately 65,000 bpd operating capacity, originating near the Partnership s Nederland Terminal, and terminating at Longview Texas; (b) the Kilgore Pipeline, a 190-mile, 10-inch crude oil pipeline with approximately 35,000 barrel per day capacity originating in Kilgore, Texas and terminating at refineries in the Houston, Texas region; (c) approximately 900,000 shell barrels of storage capacity at Kilgore, and Longview, Texas, approximately 550,000 of which are inactive; (d) a crude oil sales and marketing business; and (e) crude oil line fill and working inventory. The purchase price of the acquisition was funded with borrowings under the Partnership s Credit Facility. The purchase price has been allocated to the assets acquired based on their relative fair values at the acquisition date. The following is a summary of the effects of the transaction on the Partnership s consolidated financial position (in thousands of dollars):

Increase in:	
Inventories	$ 2,189
Properties, plants and equipment, net	38,711
Cash paid for acquisition	$ 40,900

The results of the acquisition are included in the financial statements within the Western Pipeline System business segment from the date of acquisition.

Amdel and White Oil Pipeline Acquisition

On March 1, 2006, the Partnership acquired a Texas crude oil pipeline system from Alon USA Energy, Inc. for approximately $68.0 million. The system consists of (a) the Amdel Pipeline, a 503-mile, 10-inch common carrier crude oil pipeline with approximately 27,000 bpd operating capacity, originating at the Nederland Terminal, and terminating at Midland, Texas, and (b) the White Oil Pipeline, a 25-mile, 10-inch crude oil pipeline with approximately 40,000 bpd operating capacity, originating at the Amdel Pipeline and terminating at Alon s Big Spring, Texas refinery. The pipelines were idle at the time of purchase, were re-commissioned by the Partnership during the second quarter 2006 and began making deliveries during the fourth quarter 2006. During the first quarter of 2007, the Partnership completed a project to expand the capacity on the Amdel Pipeline from approximately 27,000 to 40,000 bpd. Construction on new tankage at the Nederland Terminal to service these new volumes more efficiently is expected to be completed during 2007. The purchase price of the acquisition was funded with borrowings under the Partnership s Credit Facility, and has been allocated to property, plants and equipment based on the relative fair value of the assets acquired on the acquisition date. The results of the acquisition are included in the financial statements within the Western Pipeline System business segment from the date of acquisition.

3. Related Party Transactions

Advances To and From Affiliates

The Partnership has a treasury services agreement with Sunoco pursuant to which it, among other things, participates in Sunoco s centralized cash management program. Under this program, all of the Partnership s cash receipts and cash disbursements are processed, together with those of Sunoco and its other subsidiaries, through Sunoco s cash accounts with a corresponding credit or charge to an intercompany account. The intercompany balances are settled periodically, but no less frequently than monthly. Amounts due from Sunoco earn interest at a rate equal to the average rate of the Partnership s third-party money market investments, while amounts due to Sunoco bear interest at a rate equal to the interest rate provided in the Partnership s revolving credit facility (see Note 6).

Selling, general and administrative expenses in the condensed consolidated statements of income include costs incurred by Sunoco for the provision of certain centralized corporate functions such as legal, accounting, treasury, engineering, information technology, insurance and other corporate services, including the administration of employee benefit plans. These are provided to the Partnership under an omnibus agreement (Omnibus Agreement) with Sunoco for an annual administrative fee. The fee for the annual period ended December 31, 2006 was $7.7 million. In January 2007, the parties extended the term of Section 4.1 of the Omnibus Agreement (which concerns the Partnership s obligation to pay the annual fee for provision of certain general and administrative services) by one year. The annual administrative fee applicable to this one-year extension is $6.5 million, which reflects the Partnership directly incurring some of these general and administrative costs. These costs may be increased if the acquisition or construction of new assets or businesses requires an increase in the level of general and administrative services received by the Partnership. There can be no assurance that Section 4.1 of the Omnibus Agreement will be extended beyond 2007, or that, if extended, the administrative fee charged by Sunoco will be at or below the current administrative fee. In the event that the Partnership is unable to obtain such services from Sunoco or third parties at or below the current cost, the Partnership s financial condition and results of operations may be adversely impacted.

The annual administrative fee does not include the costs of shared insurance programs, which are allocated to the Partnership based upon its share of the cash premiums incurred. This fee also does not include salaries of pipeline and terminal personnel or other employees of the general partner, or the cost of their employee benefits. These employees are employees of the Partnership s general partner or its affiliates, which are wholly-owned subsidiaries of Sunoco. The Partnership has no employees. Allocated Sunoco employee benefit plan expenses for employees who work in the pipeline, terminalling, storage and crude oil gathering operations, including senior executives, include non-contributory defined benefit retirement plans, defined contribution 401(k) plans, employee and retiree medical, dental and life insurance plans, incentive compensation plans, and other such benefits. The Partnership is reimbursing Sunoco for these costs and other direct expenses incurred on its behalf. These expenses are reflected in cost of products sold and operating expenses and selling, general and administrative expenses in the condensed consolidated statements of income.

Accounts Receivable, Affiliated Companies

Affiliated revenues in the condensed consolidated statements of income consist of sales of crude oil as well as the provision of crude oil and refined product pipeline transportation, terminalling and storage services to Sunoco. Sales of crude oil are priced using market based rates. Pipeline revenues are generally determined using posted tariffs. In 2002, the Partnership entered into the pipelines and terminals storage and throughput agreement and various other agreements with Sunoco under which the Partnership is charging Sunoco fees for services provided under these agreements that, in management s opinion, are comparable to those charged in arm s-length, third-party transactions. During the first quarter of 2007, the agreement to throughput at the Partnership s refined product terminals and to receive and deliver refined product into the Partnership s Marcus Hook Tank Farm expired. During the second quarter of 2007, the Partnership executed new agreements with Sunoco for five years to provide these services.

Under various other agreements, Sunoco is, among other things, purchasing from the Partnership, at market-based rates, particular grades of crude oil that the Partnership s crude oil acquisition and marketing business purchases for delivery to certain pipelines. These agreements automatically renew on a monthly basis unless terminated by either party on 30 days written notice. Sunoco also leases the Partnership s 58 miles of interrefinery pipelines between Sunoco s Philadelphia and Marcus Hook refineries for a term of 20 years.

Capital Contributions

The Partnership has agreements with Sunoco which requires Sunoco to, among other things, reimburse the Partnership for certain expenditures. These agreements include:

the Interrefinery Lease Agreement, which requires Sunoco to reimburse the Partnership for any non-routine maintenance expenditures incurred, as defined through February 2022; and

the Eagle Point purchase agreement, which requires Sunoco to reimburse the Partnership for certain capital improvement projects incurred regarding the assets acquired, as defined, up to $5.0 million through March 2014. The Partnership has received $2.5 million to date under this agreement.

During the first quarter 2007, the Partnership was reimbursed $0.7 million associated with these agreements. There were no amounts reimbursed during the first quarter 2006. The reimbursement of these amounts was recorded by the Partnership as capital contributions to Partners Capital within the condensed consolidated balance sheet at March 31, 2007.

In May 2006, the Partnership sold 2.4 million common units in a public offering. In June 2006, the Partnership sold an additional 280,000 common units to cover over-allotments in connection with the May 2006 sale (see Note 9). As a result of this issuance of 2.680 million common units, the general partner contributed $2.4 million to the Partnership to maintain its 2.0 percent general partner interest. The Partnership recorded this amount as a capital contribution to Partners Capital within its condensed consolidated balance sheet.

In February 2007 and 2006, the Partnership issued 0.1 million common units in each period to participants in the Sunoco Partners LLC Long-Term Incentive Plan (LTIP) upon completion of award vesting requirements. As a result of these issuances of common units, the general partner contributed $0.1 million in each period to the Partnership to maintain its 2.0 percent general partner interest. The Partnership recorded these amounts as capital contributions to Partners Capital within its condensed consolidated balance sheets.

Asset Acquisition

On August 18, 2006, the Partnership purchased from Sunoco a 100 percent interest in Sun Pipe Line Company of Delaware LLC, the owner of a 55.3 percent equity interest (50 percent voting rights) in Mid-Valley Pipeline Company (Mid-Valley) for approximately $65 million, subject to certain adjustments five years following the date of closing, based on throughput of Sunoco (see Note 2). Since the acquisition was from a related party, the interest in the entity was recorded by the Partnership at Sunoco s historical cost of approximately $12.5 million, and the $52.5 million difference between the purchase price and the cost basis of the assets was recorded by the Partnership as a capital distribution.

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Conversion of Subordinated Units

A total of 11,383,639 subordinated limited partner units, equal to all of the originally issued subordinated units held by the general partner, have been converted into common units on a one-for-one basis, 2,845,910 each on February 15, 2005 and February 15, 2006 and 5,691,819 on February 15, 2007 (see Note 10).

4. Net Income Per Unit Data

Basic and diluted net income per limited partner unit is calculated by dividing net income, after deducting the amount allocated to the general partner s interest, by the weighted-average number of limited partner common and subordinated units outstanding during the period.

The general partner s interest in net income consists of its 2.0 percent general partner interest and incentive distributions , which are increasing percentages, up to 50 percent of quarterly distributions in excess of $0.50 per limited partner unit (see Note 10). The general partner was allocated net income of $2.1 million (representing 9.3 percent of total net income for the period) and $1.3 million (representing 7.3 percent of total net income for the period) for the three months ended March 31, 2007 and 2006, respectively. Diluted net income per limited partner unit is calculated by dividing net income applicable to limited partners by the sum of the weighted-average number of common and subordinated units outstanding and the dilutive effect of incentive unit awards, as calculated by the treasury stock method.

The following table sets forth the reconciliation of the weighted average number of limited partner units used to compute basic net income per limited partner unit to those used to compute diluted net income per limited partner unit for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31,	
	2007	**2006**
Weighted average number of limited partner units outstanding basic	28,564,996	25,819,210
Add effect of dilutive unit incentive awards	137,732	125,542
Weighted average number of limited partner units diluted	28,702,728	25,944,752

5. Investment in Affiliates

The Partnership s ownership percentages in corporate joint ventures as of March 31, 2007 and December 31, 2006 are as follows:

	Partnership Ownership Percentage
Mid-Valley Pipeline Company [1]	55.3%
West Texas Gulf Pipe Line Company	43.8%
Wolverine Pipe Line Company	31.5%
Yellowstone Pipe Line Company	14.0%
West Shore Pipe Line Company	12.3%
Explorer Pipeline Company	9.4%

(1) The Partnership s interest in the Mid-Valley Pipeline Company includes 50 percent voting

rights.

The following table provides summarized combined statement of income data on a 100 percent basis for the Partnership s corporate joint venture interests for the three months ended March 31, 2007 and 2006 (in thousands of dollars):

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	Three Months Ended March 31, 2007	Three Months Ended March 31, 2006
Income Statement Data:		
Total revenues	$109,689	$83,356
Net income	$ 29,972	$20,738

The following table provides summarized combined balance sheet data on a 100 percent basis for the Partnership s corporate joint venture interests as of March 31, 2007 and December 31, 2006 (in thousands of dollars):

	March 31, 2007	December 31, 2006
Balance Sheet Data:		
Current assets	$119,944	$104,276
Non-current assets	$488,768	$489,514
Current liabilities	$123,169	$111,476
Non-current liabilities	$397,511	$399,826
Net equity	$ 88,032	$ 83,028

The Partnership s investments in Wolverine, West Shore, Yellowstone, and West Texas Gulf at March 31, 2007 include an excess investment amount of approximately $54.8 million, net of accumulated amortization of $2.8 million. The excess investment is the difference between the investment balance and the Partnership s proportionate share of the net assets of the entities. The excess investment was allocated to the underlying tangible and intangible assets. Other than land and indefinite-lived intangible assets, all amounts allocated, principally to pipeline and related assets, are amortized using the straight-line method over their estimated useful life of 40 years and included within depreciation and amortization in the condensed consolidated statements of income.

6. Long-Term Debt

The components of long-term debt are as follows (in thousands of dollars):

	March 31, 2007	December 31, 2006
Credit Facility	$ 116,000	$ 68,000
Senior Notes 7.25%, due February 15, 2012	250,000	250,000
Senior Notes 6.125%, due May 15, 2016	175,000	175,000
Less unamortized bond discount	(1,041)	(1,090)
	$ 539,959	$ 491,910

Sunoco Logistics Partners Operations L.P. (the Operating Partnership), a wholly-owned entity of the Partnership, has a $300 million Credit Facility available to fund the Operating Partnership s working capital requirements, to finance future acquisitions and for general partnership purposes. It may also be used to fund the quarterly distribution to a maximum of $20.0 million. Borrowing under this distribution sublimit must be reduced to zero each year for a 15-day period. The Credit Facility matures in November 2010 and may be prepaid at any time. It bears interest at the Operating Partnership s option, at either (i) LIBOR plus an applicable margin or (ii) the higher of the federal funds rate plus 0.50 percent or the Citibank prime rate (each plus the applicable margin). There were $116.0 million of outstanding borrowings under the Credit Facility at March 31, 2007. The Credit Facility contains various covenants limiting the Operating Partnership s ability to incur indebtedness; grant certain liens; make certain loans, acquisitions and investments; make any material change to the nature of its business; acquire another company; or enter into a merger or sale of assets, including the sale or transfer of interests in the Operating Partnership s subsidiaries. The

Credit Facility also contains covenants (each as defined in the credit agreement) requiring the Operating Partnership to maintain, on a rolling four-quarter basis, a maximum total debt to EBITDA ratio of 4.75 to 1, which can generally be increased to 5.25 to 1 during an acquisition period; and an interest coverage ratio of at least 3.0 to 1. The Operating Partnership is in compliance with these covenants as of March 31, 2007. The Partnership s ratio of total debt to EBITDA was 3.2 to 1 and the interest coverage ratio was 4.8 to 1 at March 31, 2007.

On March 1, 2006, the Partnership completed its acquisition of two Texas crude oil pipeline systems for approximately $108.9 million (see Note 2). The Partnership initially financed these transactions with $109.5 million of borrowings under the Credit Facility. All of the $216.1 million in borrowings outstanding under the Credit Facility were repaid in May 2006 with proceeds from the Senior Notes offering described below, together with a portion of the net proceeds from the concurrent offering of 2.68 million limited partner common units (see Note 9).

During May 2006, the Operating Partnership issued $175 million of 6.125 percent Senior Notes, due May 15, 2016 at 99.858 percent of the principal amount, for net proceeds of $173.3 million after the underwriter s commission and legal, accounting and other transaction expenses. The Senior Notes are redeemable, at a make-whole premium, and are not subject to sinking fund provisions. The Senior Notes contain various covenants limiting the Operating Partnership s ability to incur certain liens, engage in sale/leaseback transactions, or merge, consolidate or sell substantially all of its assets. The Operating Partnership is in compliance with these covenants as of March 31, 2007. The net proceeds from the Senior Notes, together with the $110.3 million in net proceeds from the concurrent offering of 2.68 million limited partner common units, were used to repay all of the $216.1 million in outstanding borrowings under the Partnership s Credit Facility. The balance of the proceeds from the offerings are being used to fund the Partnership s organic growth program and for general Partnership purposes, including to finance pending and future acquisitions.

On August 21, 2006, the Partnership purchased from Sunoco a 100 percent interest in Sun Pipe Line Company of Delaware LLC, the owner of a 55.3 percent equity interest in Mid-Valley Pipeline Company (Mid-Valley) for $65 million, subject to certain adjustments five years following the date of closing (see Note 2). The purchase price of the acquisition was funded with $46.0 million in borrowings under the Partnership s Credit Facility and with cash on hand.

The Partnership and the operating partnerships of the Operating Partnership serve as joint and several guarantors of the Senior Notes and of any obligations under the Credit Facility. The guarantees are full and unconditional. See Note 13 for supplemental condensed consolidating financial information.

7. Commitments and Contingent Liabilities

The Partnership is subject to numerous federal, state and local laws which regulate the discharge of materials into the environment or that otherwise relate to the protection of the environment. These laws and regulations result in liabilities and loss contingencies for remediation at the Partnership s facilities and at third-party or formerly owned sites. The accrued liability for environmental remediation in the condensed consolidated balance sheets was $0.5 million as of March 31, 2007 and December 31, 2006. There are no liabilities attributable to unasserted claims, nor have any recoveries from insurance been assumed.

Total future costs for environmental remediation activities will depend upon, among other things, the identification of any additional sites, the determination of the extent of any contamination at each site, the timing and nature of required remedial actions, the technology available and needed to meet the various existing legal requirements, the nature and extent of future environmental laws, inflation rates and the determination of the Partnership s liability at multi-party sites, if any, in light of uncertainties with respect to joint and several liability, and the number, participation levels and financial viability of other parties. As discussed below, the Partnership s future costs will also be impacted by an indemnification from Sunoco.

Sunoco has indemnified the Partnership for 30 years from environmental and toxic tort liabilities related to the assets contributed to the Partnership that arise from the operation of such assets prior to the closing of the Partnership s initial public offering (IPO) on February 8, 2002. Sunoco has indemnified the Partnership for 100 percent of all such losses asserted within the first 21 years of closing of the February 2002 IPO. Sunoco s share of liability for claims asserted thereafter will decrease by 10 percent a year. For example, for a claim asserted during the twenty-third year after closing of the February 2002 IPO, Sunoco would be required to indemnify the Partnership for 80 percent of its loss. There is no monetary cap on the amount of indemnity coverage provided by Sunoco. The Partnership has agreed to indemnify Sunoco and its affiliates for events and conditions associated with the operation of the Partnership s assets that occur on or after the closing of the February 2002 IPO and for environmental and toxic tort liabilities to the extent Sunoco is not required to indemnify the Partnership.

Sunoco has also indemnified the Partnership for liabilities, other than environmental and toxic tort liabilities related to the assets contributed to the Partnership, that arise out of Sunoco s ownership and operation of the assets prior to the closing of the February 2002 IPO and that are asserted within 10 years after closing of the February 2002 IPO. In addition, Sunoco has indemnified the Partnership from liabilities relating to certain defects in title to the assets contributed to the Partnership and associated with failure to obtain certain consents and permits necessary to conduct its business that arise within 10 years after closing of the February 2002 IPO as well as from liabilities relating to legal actions pending against Sunoco or its affiliates as of February 2, 2002, or events and conditions associated with any assets retained by Sunoco or its affiliates.

Management of the Partnership does not believe that any liabilities which may arise from claims indemnified by Sunoco would be material in relation to the consolidated financial position of the Partnership at March 31, 2007. There are certain other pending legal proceedings related to matters arising after the February 2002 IPO which are not indemnified by

Sunoco. Management believes that any liabilities that may arise from these legal proceedings will not be material in relation to the consolidated financial position of the Partnership at March 31, 2007.

8. Management Incentive Plan

Sunoco Partners LLC, the general partner of the Partnership, has adopted the Sunoco Partners LLC Long-Term Incentive Plan (LTIP) for employees and directors of the general partner who perform services for the Partnership. The LTIP is administered by the independent directors of the Compensation Committee of the general partner s board of directors with respect to employee awards, and by the non-independent members of the general partners board of directors with respect to awards granted to the independent directors. The LTIP currently permits the grant of restricted units and unit options covering an aggregate of 1,250,000 common units. There have been no grants of unit options since the inception of the LTIP. Restricted unit awards under the Partnership s LTIP generally vest upon completion of a three-year service period. For performance-based awards, adjustments for attainment of performance targets can range from 0 200 percent of the award grant, and are payable in common units. Restricted unit awards may also include tandem distribution equivalent rights (DERs) at the discretion of the Compensation Committee. Subject to applicable vesting criteria, a DER entitles the grantee to a cash payment equal to cash distributions paid on an outstanding common unit during the period the restricted unit is outstanding. DERs are recognized as a reduction of Partners Capital as they become vested.

As of March 31, 2007, there were approximately 0.2 million unvested restricted units outstanding with a weighted average grant-date fair value of $45.05 per unit, and a contractual life of three years. As of March 31, 2007, total compensation cost related to non-vested awards not yet recognized was $2.3.million, and the weighted-average period over which this cost is expected to be recognized in expense is 2.1 years. The number of restricted stock units outstanding and the total compensation cost related to non-vested awards not yet recognized reflect the Partnership s estimates of performance factors pertaining to performance-based restricted unit awards.

Effective January 1, 2006, the Partnership adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), using the modified-prospective method. SFAS No. 123R revised the accounting for stock-based compensation required by Statement of Financial Accounting Standards No. 123 Accounting for Stock-Based Compensation (SFAS No. 123). Among other things, SFAS No. 123R requires a fair-value-based method of accounting for share-based payment transactions, which is similar to the method followed by the Partnership under the provisions of SFAS No. 123.

SFAS No. 123R also requires the use of a non-substantive vesting period approach for new share-based payment awards that vest when an employee becomes retirement eligible, as is the case under the Partnership s LTIP (i.e., the vesting period cannot exceed the date an employee becomes retirement eligible). The effect will be to accelerate expense recognition compared to the vesting period approach that the Partnership previously followed under SFAS No. 123. As a result of adopting Statement 123(R) on January 1, 2006, the Partnership s net income is $1.4 million lower for the three months ended March 31, 2007, than if it had continued to account for share-based compensation under SFAS No. 123. Basic and diluted earnings per unit are $0.02 and $0.03, respectively, lower for the three months ended March 31, 2007 than if the Partnership had continued to account for share-based compensation under SFAS No. 123. The future impact of the non-substantive vesting period will be dependent upon the value of future stock-based awards granted to employees who are eligible to retire prior to the normal vesting periods of the awards.

The Partnership recognized share-based compensation expense related to the LTIP of approximately $2.3 million in the first quarter of 2007 and $0.9 million for the first quarter 2006. During the first quarter of 2007, the Partnership issued 50,410 new common units (after netting for taxes of approximately $1.5 million) and made DER-related payments of approximately $0.6 million in connection with the vesting.

9. Equity Offerings

In May 2006, the Partnership sold 2.4 million common units in a public offering at a price of $43.00 per unit. In June 2006, the Partnership sold an additional 280,000 common units to cover over-allotments in connection with the May 2006 sale. The purchase price for the over allotment was equal to the offering price in the May 2006 sale. The total sale of units resulted in gross proceeds of $115.2 million, and net proceeds of $110.3 million, after the underwriters commission and legal, accounting and other transaction expenses. Net proceeds of the offering, together with the $173.3 million in net proceeds from the concurrent offering of Senior Notes (see Note 6), were used to repay

$216.1 million of the debt incurred under the revolving credit facility, to fund the Partnership s 2006 organic growth program, and for general partnership purposes. Also as a result of the issuance of these units, the general partner contributed $2.4 million to the Partnership to maintain its 2.0 percent general partner interest. At March 31, 2007, Sunoco s ownership in the Partnership, including its 2.0 percent general partner interest, was 43.4 percent.

10. Cash Distributions

Within 45 days after the end of each quarter, the Partnership distributes all cash on hand at the end of the quarter, less reserves established by the general partner in its discretion. This is defined as available cash in the partnership agreement. The general partner has broad discretion to establish cash reserves that it determines are necessary or appropriate to properly conduct the Partnership s business. The Partnership will make quarterly distributions to the extent there is sufficient cash from operations after establishment of cash reserves and payment of fees and expenses, including payments to the general partner.

The Partnership issued 11,383,639 subordinated units to its general partner in connection with the February 2002 IPO. The Partnership had 5,691,819 subordinated units outstanding as of December 31, 2006, all of which were held by the general partner, and for which there is no established public trading market. Any subordinated units that remain outstanding at the end of the subordination period convert to common units on a one-for-one basis if the Partnership meets certain required financial tests set forth in the Partnership Agreement. Upon conversion to common units, the subordinated units will no longer be subordinated to the rights of the holders of common units.

The Partnership has met the minimum quarterly distribution requirements on all outstanding units for each of the four-quarter periods ended December 31, 2004, 2005 and 2006. As a result, the total of 11,383,639 subordinated units have been converted into common units on a one-for-one basis, 2,845,910 each on February 15, 2005 and February 15, 2006 and 5,691,819 on February 15, 2007.

The Partnership will, in general, pay cash distributions each quarter in the following manner:

	Percentage of Distributions	
Quarterly Cash Distribution Amount per Unit	**Unitholders**	**General Partner**
Up to minimum quarterly distribution ($0.45 per Unit)	98%	2%
Above $0.45 per Unit up to $0.50 per Unit	98%	2%
Above $0.50 per Unit up to $0.575 per Unit	85%	15%
Above $0.575 per Unit up to $0.70 per Unit	75%	25%
Above $0.70 per Unit	50%	50%

If cash distributions exceed $0.50 per unit in a quarter, the general partner will receive increasing percentages, up to 50 percent, of the cash distributed in excess of that amount. These distributions are referred to as incentive d