AP CAPITAL RESEARCH

M&A Deal of The Week

SUNOCO X NUSTAR

WRITTEN BY
Samuel Thompson

EDITED BY
AVISH PATEL

DATE
20th February 2024

Executive Summary

M&A DEAL OF THE WEEK

Deal Summary

- On Monday, January 22nd, Sunoco LP (NYSE-SUN), a wholesale distributor of motor fuel, announced that it had entered into a definitive agreement to acquire fuel storage and pipeline operator NuStar Energy (NYSE-NS) for $7.3 billion in an all-equity deal. This deal represents a 24% premium based on a 30-day volume-weighted average price (VWAP) or a 31.9% premium based on Friday's closing price.
- The equity portion of the deal equates to $2.99 billion, and NuStar's shareholders stand to receive 0.400 of a Sunoco share for each NuStar share they hold.
- This acquisition aims to diversify Sunoco's core business beyond motor fuel distribution while taking advantage of vertical integration between two established businesses. Sunoco executives said, "Having the fuel distribution business helps keep your midstream assets full, and often these assets provide a foundation for additional growth and supply synergies", highlighting the benefits of vertical integration.
- This acquisition is expected to be immediately accretive, with a 10% or more accretion to distributable cash flow and at least $150 million of run-rate synergies by the third-year close.
- Sunoco has secured a $1.6 billion 364-day bridge term loan to finance this acquisition, and the boards of both companies have unanimously approved the transaction.
- The acquisition is expected to close in the second quarter of 2024.

Deal Advisors

Sunoco:
Exclusive Financial Advisor:
Truist Securities

NuStar:
Exclusive Financial Advisor:
Barclays

Key Figures

- **Offer premium**: 24%
- **Sunoco Market Cap**: $5.1 billion
- **Synergies -** Minimum $150 million cost synergies
- **NuStar Equity Value:** $2.99billion
- **NuStar: 2023 EV/EBITDA -** 9.6x
- **NuStar Enterprise Value -** $6.44 billion

Company Information

M&A DEAL OF THE WEEK

Sunoco LP (NYSE: SUN)

- Sunoco LP, a limited partnership established in 1886, is involved in the distribution and retail sale of motor fuels. Sunoco is famous for being the official fuel provider for NASCAR, an American racing championship. They operate exclusively within the US and generate 97% of their revenue from fuel distribution and marketing activities, the rest from leases and non-motor fuel sales.
- Sunoco used to own and operate convenience stores in the US but has since divested its remaining convenience stores to 7-Eleven to focus more on growing its gasoline business. However, this was when Sunoco was struggling to manage its debt and was making losses, but it became profitable again in 2018 and has remained ever since.
- Concerning financials, the latest quarterly earnings for Sunoco equalled a Q3 revenue of $6.17 billion, down 4% from 2022 and a net income of $272 million, up 327% from 2022 Q3's $82 million. This significant increase was driven by a 4% fall in Sunoco's cost of sales, leading to a 2023 Q3 EPS of $2.99 and a P/E of 10.8x, which places Sunoco above the peer average of 4.2x.

NuStar Energy (NYSE: NS)

- Founded in 2001, NuStar operates in the transportation and storage of petroleum products and other such chemicals. NuStar's business is broken into three segments: pipeline, fuel marketing, and storage. The pipeline segment is the company's main driver and is responsible for 55% of NuStar's revenue in 2022. Storage and Fuels Marketing account for the remaining 26% and 20%, respectively.
- NuStar's financial success has fluctuated over the past decade, with varying levels of profitability. However, over the last two years, they have remained profitable. The fluctuations in profitability are due to changes in revenue, which peaked in 2011 at $6.26 billion and have since declined exponentially until 2017 when they remained stagnant. The reason for these revenue fluctuations is a fall in demand for their pipeline services, which is the primary driver of NuStar's revenues.
- Regarding financials, the latest quarterly earnings for NuStar yielded Q3 revenue of $410.3 million, down 1% from 2022 and a net income of $51.2 million, down 14% from 2022 Q3's $59 million. This led to a 2023 Q3 EPS of $0.20 and a P/E of 49.0x.

Deal Rationale and Risk

M&A DEAL OF THE WEEK

Diversification, Scaling and Cost Benefits

Diversification and Risk Reduction

- The acquisition will decrease risk and increase diversification as Sunoco relies heavily on fuel distribution for its revenue, making diversification necessary. Sunoco can add to its portfolio upstream pipelines for petroleum and ammonium products and a fast-growing renewables business and product terminals by acquiring NuStar. These additions can be integrated into Sunoco's operations, providing Sunoco with the required diversification.

Offers Scaling Potential

- This acquisition offers Sunoco the potential to expand current operations into the Northern section of the US or the Dakota/Minnesota region, where their current presence is considerably low. This will be done by utilising NuStar's Midstream assets, which are heavily based in the Dakota/Minnesota region and will be used as a foundation for growth and scaling up into this new region.

Increased Efficiency

- This acquisition will result in a minimum of $150 million in synergies and economies of scale. Additionally, the increased utilisation of NuStar's storage terminals will increase asset utilisation.

Risk

- **NuStar's Debt** - The primary source of risk in this acquisition is the issue of NuStar's chronic debt. NuStar currently has a D/E ratio of 3.26, which is an all-time high for NuStar. This is because of a decline in market capitalisation since 2019, while debt has remained constant at around $3-3.5 billion over the last 5 years.
- **Nustar's Liquidity** - NuStar's current ratio is 0.78, implying they don't have sufficient liquidity to meet their short-term liabilities of $256.2 million as they only have short-term assets of $199.6 million. This low current ratio acts as a warning sign for poor performance as, in years when NuStar's current ratio was lower than 1.0x, the company failed to generate a profit; an example of this being the 2017-2018 period. Their interest coverage ratio is only 1.9x which is considered low when compared to Sunoco's, which is 2.9x.
- **Sunoco Debt**- Sunoco has a poor track record of being highly leveraged and has a current D/E of 3.15. This is similar to NuStar's and is expected to sit at around the target level of 4.0, 12-18 months post-close, due to Sunoco acquiring new finance to cover this deal. Their current ratio sits at 1.7, more than double NuStar's.

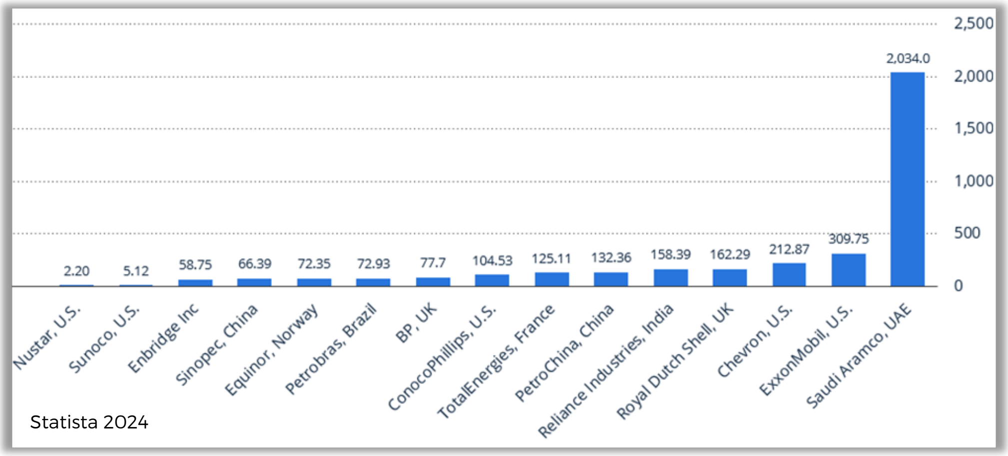
Industry Analysis

M&A DEAL OF THE WEEK

The Oil and Gas Industry

- The Oil and Gas industry is one of the biggest industries in the world due to the constant demand for petroleum products such as fuel and gas. It is currently dominated by Saudi Aramco, with ExxonMobil trailing second, as shown in the graph below, which in late October acquired Pioneer Resources for $59 billion.

Leading oil and gas companies worldwide based on market capitalization as of December 2023 (in billion U.S. dollars)



Oil and Gas Growth Rate

- The Oil and Gas Industry in the U.S. is expected to grow at a Compound Annual Growth Rate of approximately 4% from 2024 to 2029.

- This low CAGR in the Oil and Gas industry is not surprising, as the industry is already highly consolidated and has undergone significant growth during the 20th century. However, the industry may be on the verge of a potential decline in the coming decades as low-carbon alternatives are explored further.

Threats

- A major threat to the Oil and Gas industry is climate change regulations, as the production and consumption of oil and gas is very carbon intensive, contributing to climate change. Many countries have set net-zero emission targets by 2050, which has forced many Oil and Gas companies to invest significantly in alternative energy sources like wind and solar.
- These companies are also enhancing their Environmental, Social, and Governance (ESG) presence to remain competitive and avoid going out of business.

Final Thoughts

M&A DEAL OF THE WEEK

Samuel Thompson

This acquisition is good for Sunoco as it allows them to utilise NuStar's pipelines and infrastructure as a foundation to scale up their business. Furthermore, this deal delivers the necessary diversification that Sunoco requires while reducing reliance upon the distribution of fuel as a source of revenue, as currently, without this, Sunoco would not be able to conduct business.

With regards to the valuation of NuStar, Sunoco will not have overpaid. Compared to a DCF analysis, NuStar's implied value per share was $18.02, which was 4% undervalued before Sunoco's acquisition announcement. This 4% undervaluation, plus a 24% premium per share, represents a good deal because of NuStar's scalability and growth prospects for Sunoco.

SAMUEL THOMPSON
M&A ANALYST
Sjbt2015@gmail.com

AVISH PATEL
AP Capital Director
avishpatel92@gmail.com

Disclaimer

M&A DEAL OF THE WEEK