

SunCoke Energy, Inc.
Form 10-Q
November 02, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

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 001-35423

SUNCOKE ENERGY, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

1011 Warrenville Road, Suite 600

Lisle, Illinois 60532

(630) 824-1000

(Registrant's telephone number, including area code)

90-0640593
(I.R.S. Employer
Identification No.)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

As of October 31, 2011, there were 70,005,781 shares of the Registrant's Common Stock outstanding.

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PART I FINANCIAL INFORMATION

Explanatory Note

On July 18, 2011 (Separation Date), Sunoco, Inc. (Sunoco) contributed the subsidiaries, assets and liabilities that were primarily related to its cokemaking and coal mining operations to SunCoke Energy, Inc. (SunCoke Energy or the Company) in exchange for 69,999,000 shares of SunCoke Energy common stock (the Separation). On July 26, 2011, SunCoke Energy completed the initial public offering (IPO) of 13,340,000 shares of its common stock. The unaudited combined financial statements and related discussion of financial condition and results of operations contained in this report for periods prior to the Separation Date pertain to the operations that comprised the cokemaking and coal mining operations of Sunoco prior to their transfer to SunCoke Energy and prior to the effective dates of the agreements SunCoke Energy entered into with Sunoco in connection with the IPO and the Separation. The unaudited consolidated financial statements and related discussion of financial condition and results of operations contained in this report for periods after the Separation Date pertain to the operations of SunCoke Energy. See Note 2 to the accompanying unaudited combined and consolidated financial statements for information concerning the closing of the IPO and Sunoco s current ownership of 80.9% of the outstanding common stock of SunCoke Energy.

Table of Contents**SunCoke Energy, Inc.****Combined and Consolidated Statements of Income****(Unaudited)****Item 1. Combined and Consolidated Financial Statements**

	For the Three Months Ended September 30		For the Nine Months Ended September 30	
	2011	2010	2011	2010
	(Dollars and shares in thousands, except per share amounts)			
Revenues				
Sales and other operating revenue	\$ 403,100	\$ 330,628	\$ 1,113,724	\$ 1,009,197
Other income, net	399	1,007	1,051	180
Total revenues	403,499	331,635	1,114,775	1,009,377
Costs and operating expenses				
Cost of products sold and operating expenses	332,723	254,524	933,266	773,510
Loss on firm purchase commitments (Note 7)			18,544	
Selling, general and administrative expenses	25,939	14,732	64,803	41,537
Depreciation, depletion and amortization	14,752	14,013	42,377	35,832
Total costs and operating expenses	373,414	283,269	1,058,990	850,879
Operating income	30,085	48,366	55,785	158,498
Interest income affiliate (Note 5)	1,123	6,186	12,485	17,965
Interest income	166	2	284	33
Interest cost affiliate (Note 5)	(342)	(1,330)	(3,565)	(4,422)
Interest cost	(8,860)		(8,860)	
Capitalized interest	4,633	206	5,344	421
Total financing (expense) income	(3,280)	5,064	5,688	13,997
Income before income tax expense	26,805	53,430	61,473	172,495
Income tax expense (Note 6)	5,073	12,490	10,093	41,266
Net income	21,732	40,940	51,380	131,229
Less: Net income (loss) income attributable to noncontrolling interests	3,372	3,494	(1,226)	10,466
Net income attributable to SunCoke Energy, Inc. / net parent investment	\$ 18,360	\$ 37,446	\$ 52,606	\$ 120,763
Earnings per common share (Note 14):				
Basic	\$ 0.26	\$ 0.53	\$ 0.75	\$ 1.73
Diluted	\$ 0.26	\$ 0.53	\$ 0.75	\$ 1.73
Weighted average common shares outstanding (Note 14):				
Basic	70,000	70,000	70,000	70,000
Diluted	70,000	70,000	70,000	70,000

(See Accompanying Notes)

Table of Contents**SunCoke Energy, Inc.****Combined and Consolidated Balance Sheets**

	September 30, 2011 (Unaudited)	December 31, 2010
	(Dollars and shares in thousands, except per share amounts)	
Assets		
Cash and cash equivalents	\$ 110,850	\$ 40,092
Accounts receivable	52,033	44,606
Inventories (Note 7)	222,436	106,610
Receivable from affiliate	672	
Deferred income taxes	552	1,140
Total current assets	386,543	192,448
Notes receivable from affiliate (Note 5)		289,000
Investment in Brazilian cokemaking operations	40,976	40,976
Properties, plants and equipment, net	1,353,499	1,173,518
Lease and mineral rights, net	53,392	6,690
Goodwill	9,388	3,400
Deferred charges and other assets	35,396	12,434
Total assets	\$ 1,879,194	\$ 1,718,466
Liabilities and Equity		
Advances from affiliate (Note 5)	\$	\$ 888,512
Accounts payable	185,184	106,350
Current portion of long-term debt	3,000	
Accrued liabilities	51,996	53,158
Taxes payable	11,593	7,704
Total current liabilities	251,773	1,055,724
Long-term debt (Note 9)	694,784	
Payable to affiliate (Note 5)		55,813
Accrual for black lung benefits	27,538	26,605
Retirement benefit liabilities (Note 8)	45,281	42,854
Deferred income taxes	223,840	85,930
Asset retirement obligations	12,236	11,014
Other deferred credits and liabilities	19,247	11,185
Commitments and contingent liabilities (Note 10)		
Total liabilities	1,274,699	1,289,125
Equity		
Preferred stock, \$0.01 par value. Authorized 50,000 shares; no issued and outstanding shares at September 30, 2011 and December 31, 2010		
Common stock, \$0.01 par value. Authorized 300,000 shares; issued and outstanding 70,006 shares at September 30, 2011 and no shares outstanding at December 31, 2010	700	
Additional paid-in capital	556,292	
Accumulated other comprehensive income	437	

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Retained earnings	12,003	
Net parent investment		369,541
Total SunCoke Energy, Inc. stockholders equity / net parent investment	569,432	369,541
Noncontrolling interests	35,063	59,800
Total equity	604,495	429,341
Total liabilities and equity	\$ 1,879,194	\$ 1,718,466

(See Accompanying Notes)

Table of Contents**SunCoke Energy, Inc.****Combined and Consolidated Statements of Cash Flows****(Unaudited)**

	For the Nine Months Ended September 30	
	2011	2010
	(Dollars in thousands)	
Cash Flows from Operating Activities:		
Net income	\$ 51,380	\$ 131,229
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on firm purchase commitment (Note 7)	18,544	
Depreciation, depletion and amortization	42,377	35,832
Deferred income tax expense	14,630	10,885
Payments less than (in excess of) expense for retirement plans	267	(3,081)
Changes in working capital pertaining to operating activities:		
Accounts receivable	(4,157)	41,994
Inventories	(112,822)	(1,353)
Accounts payable and accrued liabilities	53,904	42,590
Taxes payable	(2,236)	2,836
Other	(3,208)	(7,007)
Net cash provided by operating activities	58,679	253,925
Cash Flows from Investing Activities:		
Capital expenditures	(184,217)	(135,833)
Acquisition of business, net of cash received	(37,575)	
Proceeds from sales of assets		72
Net cash used in investing activities	(221,792)	(135,761)
Cash Flows from Financing Activities:		
Proceeds from issuance of long-term debt	698,500	
Debt issuance costs	(18,874)	
Repayment of long-term debt	(750)	
Purchase of noncontrolling interest in Indiana Harbor facility	(34,000)	
Net decrease in advances from affiliate	(412,783)	(113,636)
Repayments of notes payable assumed in acquisition	(2,315)	
Increase (decrease) in payable to affiliate	5,279	30,296
Cash distributions to noncontrolling interests in cokemaking operations	(1,186)	(19,296)
Net cash provided by (used in) financing activities	233,871	(102,636)
Net increase in cash and cash equivalents	70,758	15,528
Cash and cash equivalents at beginning of period	40,092	2,741
Cash and cash equivalents at end of period	\$ 110,850	\$ 18,269

(See Accompanying Notes)

Table of Contents**SunCoke Energy, Inc.****Combined and Consolidated Statement of Equity****(Unaudited)**

	Shares	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Net Parent Investment	Total SunCoke Energy, Inc. or Parent Equity	Noncontrolling Interests	Total Equity
	(Dollars and shares in thousands)								
At December 31, 2010		\$	\$	\$	\$	\$ 369,541	\$ 369,541	\$ 59,800	\$ 429,341
Net income (loss) from January 1, 2011 to July 18, 2011						40,603	40,603	(5,041)	35,562
Net income from July 19, 2011 to September 30, 2011					12,003		12,003	3,815	15,818
Retirement benefit plans funded status adjustment				(617)		(1,095)	(1,712)		(1,712)
Currency translation adjustment				(1,847)		573	(1,274)		(1,274)
Comprehensive income (loss)							49,620	(1,226)	48,394
Capital contribution from Sunoco, Inc. in connection with contribution of business						156,542	156,542		156,542
Issuance of common stock in exchange for cokemaking and coal mining operations of Sunoco, Inc.	70,000	700	562,563	2,901		(566,164)			
Share-based compensation expense	6		926				926		926
Cash distributions to noncontrolling interests								(1,186)	(1,186)
Purchase of noncontrolling interests, net of related tax benefit of \$4,695			(7,197)				(7,197)	(22,325)	(29,522)
At September 30, 2011	70,006	\$ 700	\$ 556,292	\$ 437	\$ 12,003	\$	\$ 569,432	\$ 35,063	\$ 604,495

(See Accompanying Notes)

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SunCoke Energy, Inc.

Notes to Combined and Consolidated Financial Statements

(Unaudited)

1. General

Description of Business

SunCoke Energy, Inc. (SunCoke Energy or the Company) is an independent owner and operator of four metallurgical cokemaking facilities in the eastern and midwestern regions of the United States and operator of a cokemaking facility for a project company in Brazil in which it has a preferred stock investment. The cokemaking operations include blast furnace coke manufacturing at the Company's Jewell Coke Company, L.P. (Jewell) facility in Vansant, VA; Indiana Harbor Coke Company, L.P. (Indiana Harbor) facility in East Chicago, IN; Haverhill North Coke Company (Haverhill) facility in Franklin Furnace, OH; and Gateway Energy & Coke Company, LLC (Granite City) facility in Granite City, IL. In October 2011, the Company commenced operations at the Middletown Coke Company, Inc. (Middletown) cokemaking facility and associated cogeneration power plant in Middletown, OH, which is adjacent to AK Steel's steelmaking facility.

In addition to its cokemaking operations, the Company has metallurgical coal mining operations in the eastern United States. The metallurgical coal produced from underground mines in Virginia and West Virginia is used primarily at the Jewell cokemaking facility. In January 2011, the Company acquired Harold Keene Coal Company, Inc. and its affiliated companies (HKCC or the HKCC Companies), which include two active underground mines and one active surface and highwall mine that are contiguous to the Company's existing mines for approximately \$52.0 million, including working capital and contingent consideration (Note 3).

In December 2010, Sunoco, Inc. (Sunoco) formed SunCoke Energy as a wholly-owned subsidiary. Sunoco contributed \$1,000 to SunCoke Energy in exchange for 1,000 shares of SunCoke Energy common stock. On July 18, 2011 (the Separation Date), Sunoco contributed the subsidiaries, assets and liabilities that were primarily related to its cokemaking and coal mining operations to SunCoke Energy in exchange for 69,999,000 shares of SunCoke Energy common stock. As of the Separation Date, Sunoco owned 100% of the outstanding common stock of SunCoke Energy. The contribution represented a reorganization of entities under common control and was recorded at Sunoco's carrying value. On July 26, 2011, SunCoke Energy completed the initial public offering (IPO) of 13,340,000 shares of its common stock. Sunoco plans to distribute the remaining shares of SunCoke Energy common stock it owns to Sunoco's shareholders by means of a spin-off, which Sunoco expects to occur no later than one year after the IPO. SunCoke Energy did not receive any of the proceeds of the IPO.

Concurrent with the reorganization just prior to the IPO, substantially all related party balances were settled in connection with the issuance of common stock to Sunoco, with the exception of \$575 million which was repaid in cash on July 26, 2011 with a portion of the proceeds from SunCoke Energy's issuance of approximately \$700 million in debt.

The historical combined statements for periods prior to the Separation Date include the accounts of all operations that comprised the cokemaking and coal mining operations of Sunoco, after elimination of all intercompany balances and transactions within the combined group of companies. The historical combined financial statements also include allocations of certain Sunoco corporate expenses. SunCoke Energy management believes the assumptions and methodologies underlying the allocation of general corporate overhead expenses are reasonable. However, such expenses may not be indicative of the actual level of expense that would have been incurred by SunCoke Energy if it had operated as an independent, publicly-traded company during the periods prior to the IPO or of the costs expected to be incurred in the future. See Note 5 for further information regarding allocated expenses. Because a direct ownership relationship did not exist among all the various entities comprising the Company, Sunoco's net investment in the Company is presented as net parent investment, rather than stockholders' equity, in the combined balance sheets for periods prior to the Separation Date.

Reclassifications

Certain amounts in the prior period Combined and Consolidated Financial Statements have been reclassified to conform to the current year presentation.

Quarterly Reporting

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The accompanying combined and consolidated financial statements included herein have been prepared in conformity with U.S. generally accepted accounting principles (GAAP) for interim reporting. Certain information and disclosures normally included in financial statements have been omitted pursuant to the rules and regulation of the Securities and Exchange Commission (SEC). In management s opinion, all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the results of operations, financial position and cash flows for the periods presented have been made. The results of operations for the period ended September 30, 2011 are not necessarily indicative of the operating results for the full year.

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SunCoke Energy, Inc.

Notes to Combined and Consolidated Financial Statements

(Unaudited)

2. Initial Public Offering and Related Transactions

Initial Public Offering

In December 2010, Sunoco formed SunCoke Energy as a wholly-owned subsidiary. Sunoco contributed \$1,000 to SunCoke Energy in exchange for 1,000 shares of SunCoke Energy common stock. On the Separation Date, Sunoco contributed the subsidiaries, assets and liabilities that were primarily related to its cokemaking and coal mining operations to SunCoke Energy in exchange for 69,999,000 shares of SunCoke Energy common stock. As of the Separation Date, Sunoco owned 100% of the outstanding common stock of SunCoke Energy. On July 26, 2011, SunCoke Energy completed the IPO of 13,340,000 shares of its common stock.

Immediately following the IPO, Sunoco owned 56,660,000 shares of SunCoke Energy common stock, or 80.9% of the outstanding common stock. Sunoco plans to distribute all of the shares of SunCoke Energy common stock it owns by means of a spin-off, which is a pro rata distribution by Sunoco of the shares of SunCoke Energy common stock it owns to holders of Sunoco's common stock. Sunoco expects that the spin-off will occur no later than one year after the IPO. Sunoco's agreement to complete the distribution is contingent on the satisfaction or waiver of a variety of conditions. In addition, Sunoco has the right to terminate its obligations to complete the distribution if, at any time, Sunoco's Board of Directors determines, in its sole discretion, that the distribution is not in the best interests of Sunoco or its shareholders. As a result, the distribution may not occur by the contemplated time or at all.

Arrangements Between Sunoco and SunCoke Energy, Inc.

In connection with the IPO, SunCoke Energy and Sunoco entered into certain agreements that effected the separation of SunCoke Energy's business from Sunoco (the Separation), provided a framework for its relationship with Sunoco after the separation and provided for the allocation between SunCoke Energy and Sunoco of Sunoco's assets, employees, liabilities and obligations attributable to periods prior to, at and after SunCoke Energy's separation from Sunoco.

Separation and Distribution Agreement. On the Separation Date, SunCoke Energy and Sunoco entered into the separation and distribution agreement, which set forth the agreements between SunCoke Energy and Sunoco regarding the principal corporate transactions required to effect SunCoke Energy's separation from Sunoco, the IPO and the distribution, if any, of SunCoke Energy's shares to Sunoco's shareholders (the Distribution), and other agreements governing the relationship between Sunoco and SunCoke Energy.

The separation and distribution agreement identified assets to be transferred, liabilities to be assumed and contracts to be assigned to each of SunCoke Energy and Sunoco as part of the separation of Sunoco into two companies. Except as expressly provided, all assets were transferred on an as is, where is basis. In general, each party to the separation and distribution agreement assumed liability for all pending, threatened and unasserted legal matters related to its own business or its assumed or retained liabilities and will indemnify the other party for any liability to the extent arising out of or resulting from such assumed or retained legal matters. In addition, the separation and distribution agreement provides for cross-indemnities principally designed to place financial responsibility for the obligations and liabilities of SunCoke Energy's business with SunCoke Energy and financial responsibility for the obligations and liabilities of Sunoco's business with Sunoco.

The separation and distribution agreement allocates responsibility with respect to certain employee related matters, particularly with respect to Sunoco employee benefit plans in which any SunCoke Energy employees participate or SunCoke Energy employee benefit plans which hold assets in joint trusts with Sunoco. In addition, the separation and distribution agreement provides for certain adjustments with respect to Sunoco equity compensation awards that will occur if Sunoco completes the distribution.

Tax Sharing Agreement. On the Separation Date, SunCoke Energy and Sunoco entered into a tax sharing agreement that governs the parties' respective rights, responsibilities and obligations with respect to tax liabilities and benefits, tax attributes, the preparation and filing of tax returns, the control of audits and other tax proceedings and other matters regarding taxes. For a detailed discussion of the tax sharing agreement, see Note 6.

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Transition Services Agreement. On the Separation Date, SunCoke Energy and Sunoco entered into a transition services agreement in connection with the separation. Pursuant to the transition services agreement, Sunoco provides certain support services to SunCoke Energy, including, among others, information technology, treasury, risk management and insurance, tax, internal audit

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SunCoke Energy, Inc.

Notes to Combined and Consolidated Financial Statements

(Unaudited)

and various other corporate services, in each case consistent with the services provided by Sunoco to SunCoke Energy before the separation. The charges for the transition services generally are intended to allow Sunoco to fully recover the costs directly associated with providing the services, plus all out-of-pocket costs and expenses, generally without profit. The services provided under the transition services agreement will terminate at various times specified in the agreement (generally terminating upon completion of the Distribution). SunCoke Energy may terminate certain specified services by giving prior written notice to Sunoco of such services and paying any applicable termination charge.

Guaranty, Keep Well, and Indemnification Agreement. On the Separation Date, SunCoke Energy and Sunoco entered into a guaranty, keep well, and indemnification agreement. Under this agreement, SunCoke Energy: (1) guarantees the performance of certain obligations of its subsidiaries, prior to the date that Sunoco or its affiliates may become obligated to pay or perform such obligations, including the repayment of a loan from Indiana Harbor Coke Company L.P.; (2) indemnifies, defends, and holds Sunoco and its affiliates harmless against all liabilities relating to these obligations; and (3) restricts the assets, debts, liabilities and business activities of one of its wholly owned subsidiaries, so long as certain obligations of such subsidiary remain unpaid or unperformed. In addition, SunCoke Energy releases Sunoco from its guaranty of payment of a promissory note owed by one of its subsidiaries to another of its subsidiaries.

Registration Rights Agreement. On July 26, 2011, SunCoke Energy and Sunoco entered into a registration rights agreement pursuant to which SunCoke Energy agreed that, upon the request of Sunoco, SunCoke Energy will use its reasonable best efforts to effect the registration under applicable federal and state securities laws of any shares of SunCoke Energy common stock retained by Sunoco following the IPO. Such registration rights could be used to effect any sale of SunCoke Energy common stock by Sunoco requiring registration under the Securities Act of 1933, as amended (the Securities Act).

The registration rights under the registration rights agreement will remain in effect with respect to any shares covered by the registration rights agreement until such shares have been sold pursuant to an effective registration statement under the Securities Act, such shares have been sold to the public pursuant to Rule 144 under the Securities Act and the shares are no longer restricted under the Securities Act or such shares have been sold in a transaction in which the transferee is not entitled to the benefits of the registration rights agreement.

3. Acquisition

Harold Keene Coal Company, Inc.

On January 14, 2011, the Company acquired 100% of the outstanding common shares of HKCC for approximately \$52.0 million, including working capital and contingent consideration. The results of HKCC have been included in the consolidated financial statements since that date and are included in the Coal Mining segment. HKCC engages in the business of coal mining and owns, leases, and operates mines in Russell County, Virginia. The operations of the HKCC Companies produce high volatile A and high volatile B metallurgical coals, which complement the coal produced by the Company's existing coal mining operations, and high quality thermal coal. This acquisition adds between 250,000 and 300,000 tons of coal production annually, with the potential to expand production in the future, and 21 million tons of proven and probable coal reserves located in two active underground mines and one active surface and highwall mine in Russell and Buchanan Counties in Virginia, contiguous to the Company's existing metallurgical coal mining operations. The acquisition is part of the Company's strategy to expand its domestic coal production and pursue selective reserve acquisitions. The goodwill of \$6.0 million arising from the acquisition consists largely of synergies and cost reductions.

The aggregate noncontingent portion of the purchase price was \$41.1 million, of which \$37.6 million was paid in cash, net of cash received of \$0.8 million. The remaining amount relates to a purchase price holdback of \$3.5 million that is expected to be paid in June 2012.

The purchase price includes a contingent consideration arrangement that requires the Company to pay the former owners of HKCC \$2.00 per ton of coal for each ton produced from the real property or leased property if production levels exceed 150,000 tons in a calendar year for a period of 20 years or until full exhaustion, whichever comes sooner. The potential undiscounted amount of all future payments that could be required to be paid under the contingent consideration arrangement is between \$0 and \$42 million. The fair value of the contingent consideration was \$10.9 million, and was based on significant inputs that are not observable in the market, or Level 3 inputs. Key assumptions include (a) a risk-adjusted

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discount rate range of 0.895 percent to 6.027 percent, which reflects the credit spread adjustment for each period, and (b) probability adjusted production levels of HKCC operations between 300,000 and 475,000 tons per year.

Table of Contents**SunCoke Energy, Inc.****Notes to Combined and Consolidated Financial Statements****(Unaudited)**

The following table summarizes the consideration paid for HKCC and the fair value of the assets acquired and liabilities assumed at the acquisition date (dollars in thousands):

Consideration:	
Cash, net of cash received	\$ 37,575
Working capital adjustment and purchase price hold back	3,500
Contingent consideration arrangement	10,897
Fair value of total consideration transferred	\$ 51,972
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Current assets	\$ 7,314
Property and equipment	15,466
Mineral rights	48,112
Other assets	2,429
Current liabilities	(1,507)
Deferred tax liabilities, net	(22,703)
Notes payable	(2,315)
Asset retirement obligations	(812)
Total identifiable net assets assumed	45,984
Goodwill	5,988
Total	\$ 51,972

The fair value of the acquired intangible assets, representing mineral rights, of \$47.3 million, net of asset retirement obligations of \$0.8 million, was determined by applying the income approach, and is based on significant inputs that are not observable in the market, or Level 3 inputs. The acquired intangible assets, all of which are mineral rights, are to be depleted as they are extracted, which is estimated to be over a period of 31 years.

Immediately upon acquisition, \$2.3 million of notes payable were repaid.

The acquisition of HKCC increased revenues by \$4.3 million and \$13.1 million in the third quarter and first nine months of 2011, respectively and increased gross margin by \$0.6 million and \$2.0 million in the third quarter and first nine months of 2011, respectively. The acquisition of HKCC is not material to the Company's combined and consolidated results of operations. Therefore, pro forma information has not been presented.

4. Purchase of Noncontrolling Interest

On September 30, 2011, the Company acquired the entire 19% ownership interest in the partnership that owns the Indiana Harbor cokemaking facility held by an affiliate of GE Capital for \$34.0 million. As a result of this transaction, the Company now holds an 85% interest in the partnership. The remaining 15% interest in the partnership is owned by an affiliate of DTE Energy Company.

The Company accounted for the increase in ownership as an equity transaction and resulted in a \$22.3 million decrease in noncontrolling interest and a \$7.2 million decrease in additional paid-in capital, net of income taxes. Direct costs of \$0.2 million related to the increase in ownership

were also accounted for as part of the equity transaction.

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SunCoke Energy, Inc.

Notes to Combined and Consolidated Financial Statements

(Unaudited)

5. Related Party Transactions

The related party transactions with Sunoco and its affiliates are described below.

Advances from/to Affiliate

Sunoco, Inc. (R&M), a wholly owned subsidiary of Sunoco, served as a lender and borrower of funds and a clearinghouse for the settlement of receivables and payables for the Company and Sunoco and its affiliates. Amounts due to Sunoco, Inc. (R&M) for the settlement of payables, which included advances to fund capital expenditures, amounted to \$864.3 million at December 31, 2010. Interest on such advances is based on short-term money market rates. The weighted-average annual interest rates used to determine interest expense for these amounts due were 1.4 percent for the first nine months of 2011 and 2010. As described in Note 9, on July 26, 2011, proceeds from debt issuances were used to repay \$575 million of the advances from affiliate, and the remaining balance was treated as a contribution from Sunoco and capitalized to net parent investment.

Indiana Harbor had a \$30.0 million revolving credit agreement with Sunoco, Inc. (R&M) (the Indiana Harbor Revolver), which was terminated in conjunction with the Separation. Borrowings amounted to \$24.2 million at December 31, 2010. The interest rates for advances under the Indiana Harbor Revolver were based on the one-month London Inter-Bank Offered Rate, as quoted by Bloomberg, L.P., plus 1 percent (1.26 percent at December 31, 2010).

Interest income on advances to affiliate generated by the investment of idle funds under the clearinghouse activities described above is included in interest income affiliate in the combined and consolidated statements of income and totaled \$0 million and \$0.6 million for the third quarter of 2011 and 2010, respectively, and \$0.5 million and \$1.4 million for the first nine months of 2011 and 2010, respectively. Interest paid to affiliates under the above borrowing arrangements is classified as interest cost affiliate in the combined and consolidated statements of income and totaled \$0.3 million and \$1.3 million for the third quarter of 2011 and 2010, respectively, and \$3.6 million and \$4.4 million for the first nine months of 2011 and 2010, respectively.

Receivables/Payable from/to Affiliate

During 2002, in connection with an investment in the partnership by a third-party investor, Indiana Harbor loaned \$200.0 million of excess cash to The Claymont Investment Company (Claymont), a then wholly owned subsidiary of Sunoco. The loan was evidenced by a note with an interest rate of 7.44 percent per annum. Interest income related to the note, which was paid quarterly, is included in interest income affiliate in the combined and consolidated statements of income and amounted to \$0.7 million and \$3.8 million for the third quarter of 2011 and 2010, respectively, and \$8.0 million and \$11.1 million for the first nine months of 2011 and 2010, respectively.

In 2000, in connection with an investment in the partnership by a third-party investor, Jewell loaned \$89.0 million of excess cash to Claymont. The loan was evidenced by a note with an interest rate of 8.24 percent per annum. Interest income related to the note, which was paid annually, is included in interest income affiliate in the combined and consolidated statements of income and amounted to \$0.4 million and \$1.8 million for the third quarter of 2011 and 2010, respectively, and \$4.0 million and \$5.5 million for the first nine months of 2011 and 2010, respectively.

In connection with the Separation, Sunoco contributed Claymont to SunCoke Energy primarily to transfer certain intercompany receivables from and intercompany payables to SunCoke Energy, including the notes payable to Indiana Harbor and Jewell. Accordingly, these notes receivable are now receivables and payables of SunCoke Energy's subsidiaries and the balances and related interest income are now eliminated in consolidation.

The Company had a non-interest bearing payable to affiliate totaling \$55.8 million at December 31, 2010. This intercompany balance represented the difference between the taxes allocated to the Company by Sunoco under a tax-sharing arrangement and the taxes recognized by the Company on a separate-return basis as reflected in the combined financial statements. In connection with the Separation, the payable to

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affiliate at the Separation Date was capitalized to net parent investment as discussed in the Net Parent Investment/SunCoke Energy, Inc. Stockholders' Equity section below.

Sales to Affiliate

The flue gas produced during the Haverhill cokemaking process is being utilized to generate low-pressure steam, which is being sold to the adjacent chemical manufacturing complex owned and operated by Sunoco's Chemicals business. In the third quarter of 2011, Sunoco entered into an agreement to sell this facility to Goradia Capital LLC (Goradia). Under this agreement, Goradia would assume Sunoco's obligations under the agreement. Such steam sales totaled \$2.2 million and \$2.6 million for the third quarter of 2011 and 2010, respectively, and \$7.0 million and \$6.8 million for the first nine months of 2011 and 2010, respectively.

Table of Contents**SunCoke Energy, Inc.****Notes to Combined and Consolidated Financial Statements****(Unaudited)****Allocated Expenses**

Prior to the Separation, amounts were allocated from subsidiaries of Sunoco for employee benefit costs of certain executives of the Company as well as for the cost associated with the participation of such executives in Sunoco's principal management incentive plans. The employee benefit costs were allocated as a percentage of the executives' actual pay, while the incentive plan costs represented the actual costs associated to the executives. Indirect corporate overhead attributable to the operations of the Company was also allocated from Sunoco. These overhead expenses incurred by Sunoco include costs of centralized corporate functions such as legal, accounting, tax, treasury, engineering, information technology, insurance and other corporate services. The allocation methods for these costs include estimates of the costs and level of support attributable to SunCoke for legal, accounting, tax, treasury, and engineering, usage and headcount for information technology and prior years' claims information and historical cost of insured assets for insurance.

Concurrent with the Separation, SunCoke Energy entered into a transition services agreement with Sunoco. Under this agreement, Sunoco provides certain services, the use of facilities and other assistance on a transitional basis to SunCoke Energy for fees which approximate Sunoco's cost of providing these services (Note 2).

The above allocations and transition services fee are included in cost of products sold and operating expenses and selling, general and administrative expenses in the combined and consolidated statements of income and totaled \$1.9 million and \$1.7 million in the third quarter of 2011 and 2010, respectively, and \$5.8 million and \$5.2 million for the first nine months of 2011 and 2010, respectively.

Net Parent Investment/SunCoke Energy, Inc. Stockholders' Equity

Prior to the contribution of the cokemaking and coal mining operations to SunCoke Energy, the net parent investment represented Sunoco's equity investment in the Company and reflected capital contributions and returns of capital, net income attributable to Sunoco's ownership and accumulated other comprehensive income (loss), which was all attributable to Sunoco's ownership.

In connection with the Separation, Sunoco made a capital contribution to SunCoke Energy under the terms of the Separation and Distribution Agreement which eliminated certain assets and obligations of SunCoke Energy previously reflected in its combined balance sheet. The following summarizes the impact on SunCoke Energy's combined balance sheet:

Increase (decrease) in capital contribution (dollars in thousands):

Interest receivable from affiliate	\$ 4,732
Notes receivable from affiliate	289,000
Advances from affiliate	(487,323)
Payable to affiliate	(61,092)
Deferred income taxes (Note 6)	98,141
Net capital contribution from Sunoco	\$ 156,542

In connection with the contribution of assets for shares of SunCoke Energy common stock, the appropriate components of the total net parent investment were capitalized to stockholders' equity.

During the third quarter of 2010, certain entities which are part of the Company made noncash distributions comprised of \$535.5 million of amounts receivable from Sunoco, Inc. (R&M) as a distribution of prior years' earnings of such subsidiaries to Sunoco. The receivables, which had been offset against amounts due to Sunoco, Inc. (R&M) in the combined balance sheet, were established by prior cash deposits to Sunoco,

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Inc. (R&M) resulting primarily from the subsidiaries' earnings. This transaction was treated as a noncash increase in advances from affiliate and a decrease in net parent investment. Accordingly, it is not reflected in the combined statement of cash flows for the nine months ended September 30, 2010.

Guarantees and Indemnifications

For a discussion of certain guarantees that Sunoco, Inc. is providing to the current and former third-party investors of the Indiana Harbor cokemaking operations and the former third-party investors of the Jewell cokemaking facility on behalf of the Company, see Note 10.