SXCPartners

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September 26, 2016
Queen's University
Target Price $18

Long : SunCoke Energy Partners L.P. (NYSE:SXCP)

Key Statistics

Stock Price (10/07/16)	$15.1
3 Month Avg. Volume	320,000
Market Cap. (mm)	698.7
EV (mm)	1,509.0
P/E (LTM)	7.5x
EV/EBITDA (LTM)	7.4x
Beta	1.5
Dividend Yield	15.7%
% of 52 Week High	97%

DCF Key Sensitivities

	Terminal Multiple					
	14	7.1x	7.6x	8.1x	8.6x	9.1x
WACC	7.2%	13	15	16	18	19
	8.2%	12	13	15	16	18
	9.2%	11	12	14	15	16
	10.2%	10	11	12	14	15
	11.2%	9	10	11	12	14

	Terminal Growth Rate					
	14	1.5%	1.8%	2.0%	2.3%	2.5%
WACC	7.2%	22	23	25	26	28
	8.2%	16	17	18	19	20
	9.2%	12	13	14	14	15
	10.2%	9	9	10	11	11
	11.2%	6	7	7	8	8

Company Overview

- Merchant metallurgical coke distributor with over 50 years of experience
- Core business is predicated on providing steelmakers an alternative to investing capital in their own captive coke production facilities (82% of rev.)
- Also owns an expanding coal logistics division which consists of its coal handling and mixing service
- Responsible for 23% of total coke capacity across 6 domestic coke making facilities in North America

Investment Thesis

- Decreasing coal prices since 2008 of -65.5% has caused investors to demonstrate irrational market sentiment towards this small-cap company that utilizes coal as an input and revenue generator within its operations but through contracted revenues and pass through opportunities, SXCP offers a safe and secured dividend yield of 15.7% with minimal commodity risk along with a 35% discount to its implied value

Variant Opinion

- **Dividend yield incorrectly deemed unreliable:** 82% of revenue is contracted with a weighted average contract life of 9 years and a minimum contract length of 4 years. LFCF and historic dividend growth since IPO has been constant
- **Investors wrongfully fear increased leverage from 2015:** Total debt grew at a CAGR of 55% from 2011 to 2015 causing investors to fear the potential for missed debt repayments. This debt was actually issued to finance an asset dropdown with SunCoke Energy Partners' GP assets which provides prized assets to SXCP at an attractive price to increase distributable cash flow, debt levels are also manageable with existing FCF
- **Revenue bolstered by strong customer base with limited chance of default:** Cost of coal used in production of metallurgical coke is passed on to customers if a certain coal to coke yield is met, SXCP's major contracted customers consist of the largest steel manufacturers in the world

Valuation Assumptions

- DCF model did not factor in acquisitions
- Revenue projections assumed 100% capacity on existing coke production contracts and a CAGR of 16% in the coal logistics segment till 2020E
- FF weighting was 50% towards historic 3yr. dividend yield

Financial Data

	Historical			Analyst Consensus	
	2013A	2014A	2015A	2016E	2017E
Revenue	932	873	839	754	746
COGS	715	656	600	-	-
Gross Profit	216	217	239	-	-
Gross Profit Margin %	23%	25%	28%	-	-
Net Income	57	54	77	73.3	59.3
Net Income Margin	6%	6%	9%	10%	8%
EPS	1.0	1.1	1.8	1.6	1.5
Div./Share	1.6	2.1	2.3	2.4	2.1
Dividend Payout	159%	194%	128%	152%	141%
LFCF	93.4	29.4	82.6	-	-

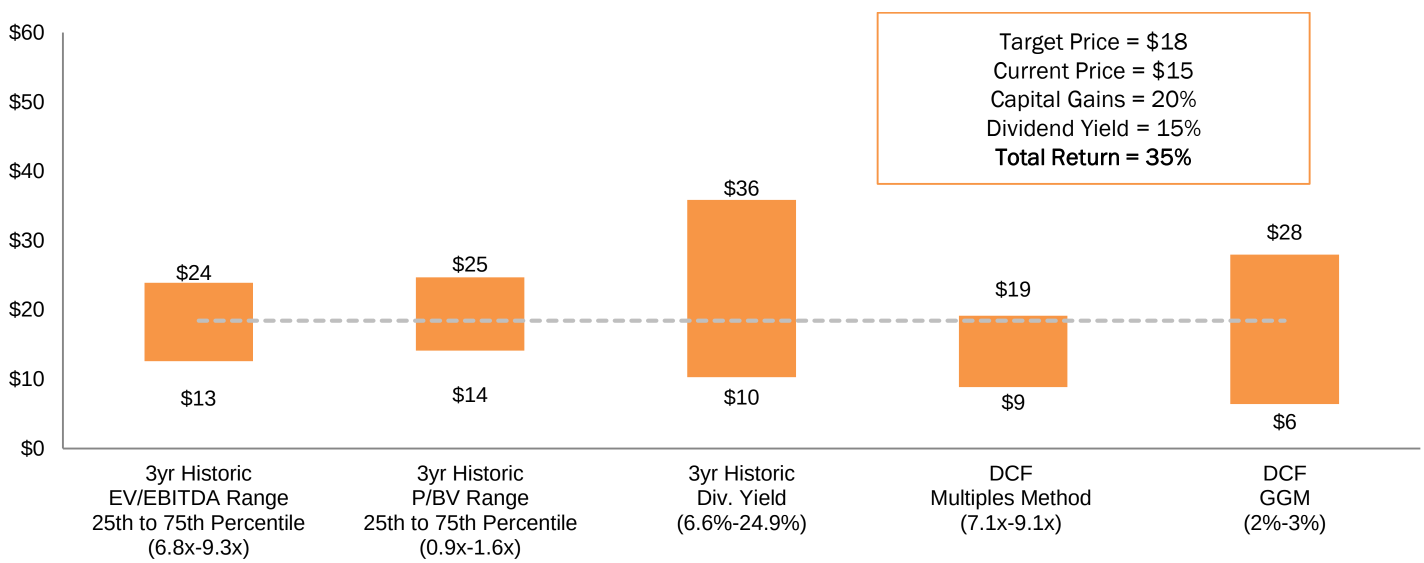
Risks

- **Rising supply equipment and replacement costs:** Unlike coal prices, equipment replacement costs are unable to be passed on to customers. If the cost of maintaining and buying equipment increases, profits may be harmed – *Mitigating factor: costs have generally been stable with minimal deviation from the historic mean*

- **Interest rate risk:** SXCP's leverage ratio has increased from 2.1x to 4.3x from 2014-2015, on a debt/capital ratio basis, this implies a jump from 30.1% to 54.6%. This exposes the company to interest rate risks on variable rate loans and risk of missed debt repayments. – *Mitigating factor: only 6.1% of loans are bank loans which generally have a variable rate associated with the debt, management also mentions in its 2015 MD&A that 2016 will be the year focused on amortizing debt*

- **Heavy reliance on contract terms:** There exists take-or-pay agreements with customers in which customers (steel manufacturers) purchase all of SXCP's capacity of coke. Reduced demand for steel may put pressure on customers and cause them to renegotiate contract terms – *Mitigating factor: customers are major players in the steel production industry ex. Arcelor Mittal, AK Steel, and United States Steel Corp. SXCP additionally has one of the highest coal to coke yields in merchant metallurgical coke production giving it a competitive advantage*

Summary of Valuations



- Comparable companies could not be used as there are no pure play existing merchant metallurgical coke producers that are public other than SXCP, therefore the company was valued on a historic multiple and DCF basis

Reasons for Existing Opportunity

- **Public investors lack understanding of contracted benefits:** 44% of ownership in SXCP stock is from public shareholders with many misinterpreting the correlation between decreasing coal prices and SXCP's contracted revenue with it being minimal

- **China's economic slowdown has caused increase pessimism on steel markets:** Customers of SXCP are steel manufacturers and decreasing demand has caused investors to assume lack of metallurgical coke purchases from SXCP. Merchant coke purchases account for a minimal amount of coke production in the United states as most of it is made in-house at steel manufacturing sites and has historically been purchased at 100% capacity from SXCP

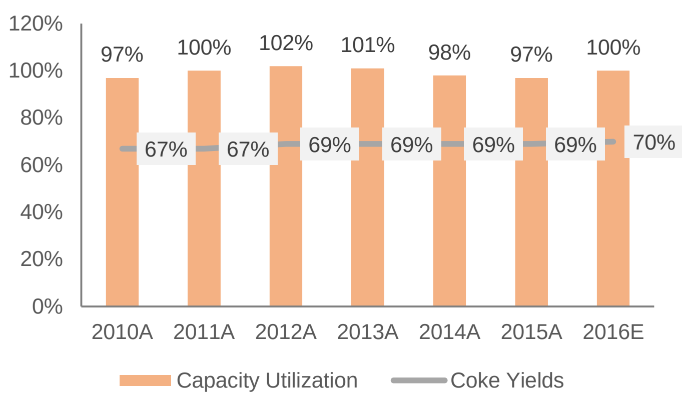
- **Continuous negative sentiment for the metals and mining industry:** iShares MSCI Global Metals & Mining Producers (PICK) which tracks upstream M&M producers has returned a CAGR of -15% for the past five years. Investors are hesitant to take large positions in an industry that has proven to provide minimal gains over the years

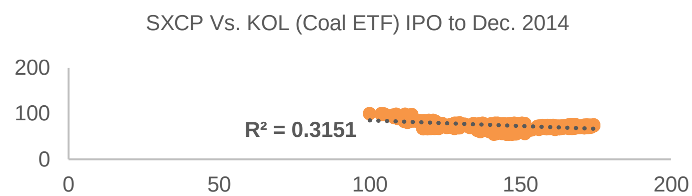
Appendix I : Thesis Details

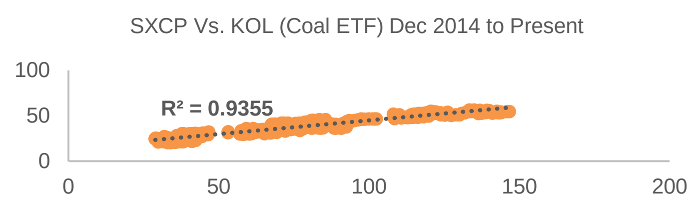
Decreasing coal prices have minimal effects on bottom-line

Contract Value Propositions
Customers required to take all coke produced up to contract max
Long-term take-or-pay brings stability during market & industry downturns
Commodity risk taken on by passing coal, transportation, & operating costs to customers
No early termination

If coal to coke yields are above the contractual standards signed by SXCP and its customers, than a pass through will occur in which the customer under the obligations of the contract pays for the cost of coal used to make SXCP's coke. Historically, coal to coke yields have not deviated drastically from the average yield of 68.3% for the past 6 years. Below is a graph highlighting historic capacity utilization and coal to coke yields. From IPO to 2014, the correlation between coal prices and SXCP stock was actually lower with an R^2 of 0.3151, this is because investors understood the business model and the details of the contract early on the company's life, overtime it became a quick way to play the commodity market and misinformed investors came in causing the correlation between SXCP and coal to increase to a R^2 value of 0.9355. It is expected that this correlation overtime will once again return back to its original levels.



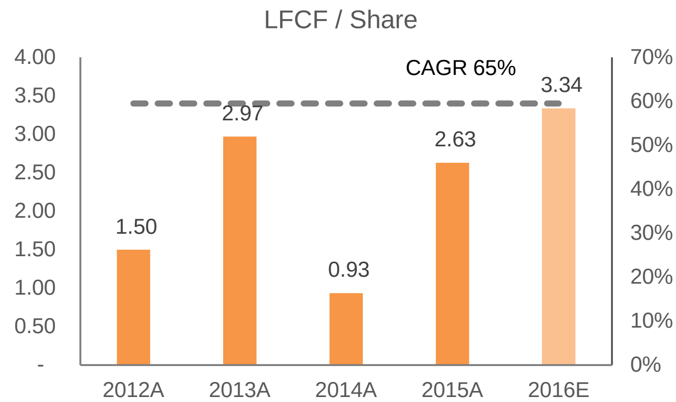


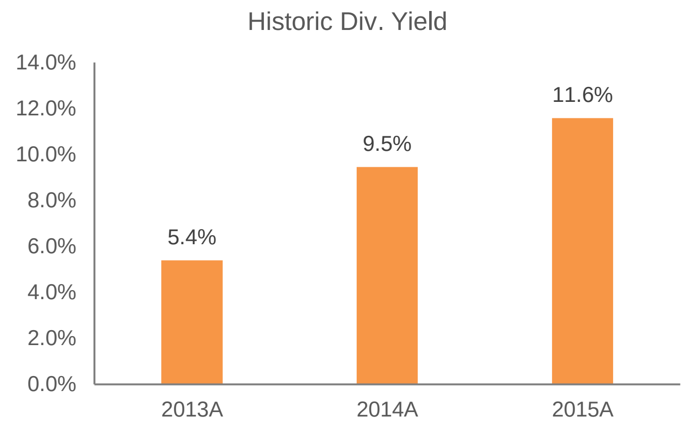


Dividend yield incorrectly deemed unreliable

Since SXCP's IPO in 2013, the company has never missed a dividend payout and has been increasing it's dividend every year. Historically, SXCP has been trading at a 5% dividend yield but due to a increased selloff last year in commodities, the company trades at ~15% yield. This dividend is safe as the company has 82% of it's total revenue contracted with a minimum contract life of 4 years and a weighted average contract life of 9. The other 18% of revenue is contributed by the coal logistics segment and may hinder dividend performance. Fortunately, the coal logistics segment has grown at a CAGR of 81% over the past 3 years and is most likely going to keep growing moving forward based off of historical growth rates. Below are details on the company's domestic coke production contracts. Furthermore, the company's dividend is bolstered by strong LFCF growth CAGR of 65% within the past 4 years. Overtime, it is assumed the company will return back to historic dividend yields of 5.4% once the market realizes how safe this dividend truly is.

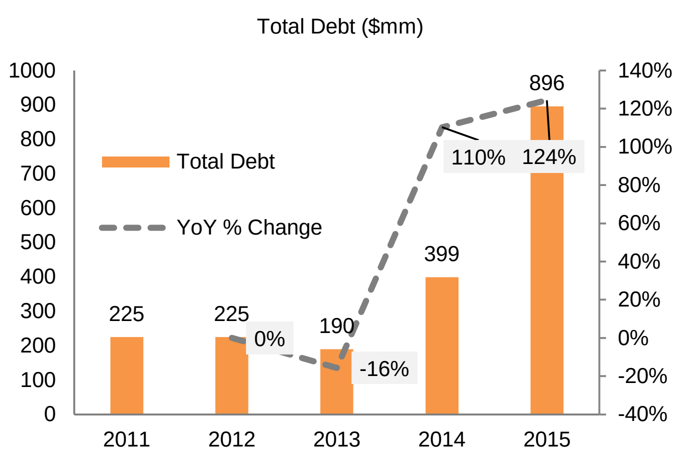
Facility	Location	Customer	Year of Startup	Contract Expiration	# of Ovens	Cokemaking Capacity (000's)
Owned & Operated						
Jewell	Vansant, Virginia	ArcelorMittal	1962	2020	142	720
Indiana Harbour	East Chicago, Indiana	ArcelorMittal	1998	2023	268	1220
Haverhill Phase I	Franklin Furnace, Ohio	ArcelorMittal	2005	2020	100	550
Haverhill Phase II	Franklin Furnace, Ohio	Ak Steel	2008	2022	100	550
Granite City	Granite City, Illinois	U.S. Steel	2009	2025	120	650
Middletown	Middletown, Ohio	AK Steel	2011	2032	100	550
Operated						
Victoria	Victoria, Brazil	ArcelorMittal	2007	2023	320	1700
Equity Method Investment						
VISA SunCoke	Odisha, India	Various	2007	n/a	88	440
Total					1238	6380

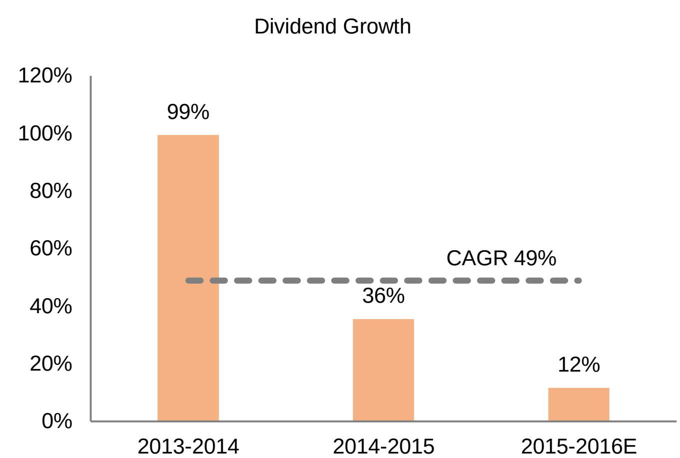


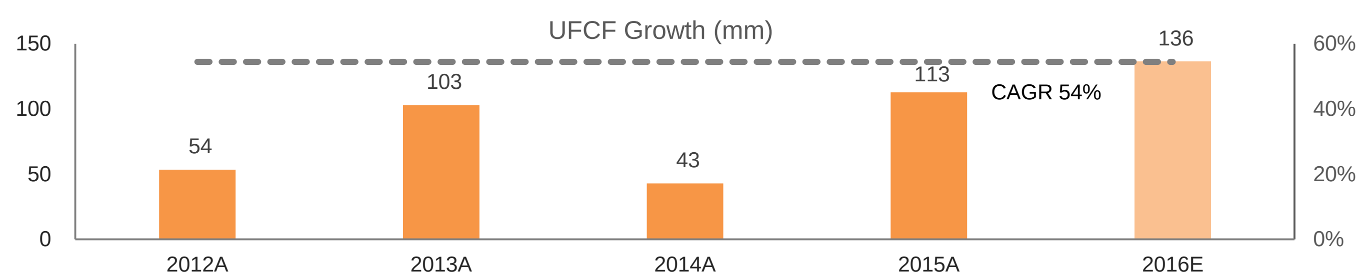


Investors wrongfully fear increased leverage

The amount of debt that SXCP has taken on over the years has increased drastically. Investors have priced in this leverage as a sign of risk. The debt was taken on to finance an asset dropdown of SunCoke GP assets which essentially is SXCP LP buying its own assets at an advantageous price. Generally, dropdowns are a good sign as GP's tend to sell off their prized assets to LP's in order to increase distributable cash flow. In 2015, SXCP paid ~$200mm for the GP's Granite City assets, the likely increase in distributable cash flow from the acquisition will offset the debt raised for the purchase. Generally, LP's receive the asset at a price that is discounted compared to a strategic acquisition of another company's assets. Therefore SXCP would've issued even more debt if it was not a dropdown purchase. An asset drop down is defined as the following: to drop down is to sell acquired assets to yourself. A drop-down transaction is the acquisition of assets by a corporation, followed by a contribution of those assets to a partnership. Additionally, SXCP's unlevered free cash flow generation over the years has been consistently positive since 2012 and is expected to grow in 2016E making the chance of missing interest and amortization payments to be slim.







Revenue bolstered by strong customer base with limited chance of default

82% of SXCP's revenue is contracted with major steel manufacturers such as U.S. Steel, Arcelor Mittal, and AK Steel. In 2015, AK Steel produced and shipped over 7 million tons of steel, while 1/5 of global car production in 2015 was from Arcelor Mittal. With roughly 25% of metallurgical coke needed to be purchased on the open market, SXCP's customers are not too dependent on merchant coke production as part of their costs. Therefore, it is unlikely steel manufacturers will renegotiate contracts when most of their resources come from in house production. SXCP also has some of the purest metallurgical coke which negates the risk of imported coke from foreign countries such as China which inherently is less pure.

Appendix II : Domestic Coke Bottom-Up Production Schedule

Projection Schedule:	Coke Full Capacity (000's)	2016E	2017E	2018E	2019E	2020E
Jewell	720	91	91	91	91	0
Indiana Harbour	1220	154	154	154	154	154
Haverhill Phase I	550	69	69	69	69	69
Haverhill Phase II	550	69	69	69	69	69
Granite City	650	82	82	82	82	82
Middletown	550	69	69	69	69	69
Victoria	1700	215	215	215	215	215
VISA SunCoke	440	56	56	56	56	56
Total Domestic Coke Rev	6380	806	806	806	806	715

4 Yr Average Rev	812
Avg Rev/000's Coke	0.13
Avg. 5 yr Capacity Utilization	99%

- Domestic coke production revenue was projected out assuming no other contracts were formed within the next 5 years. The Jewell contract expires in 4 years therefore it was assumed that no production would come from that factory in 2020E

Appendix III - A: 3-Statement Model Linked to DCF

Balance Sheet	Historical			Forecasted Period				
	2013	2014	2015	2016	2017	2018	2019	2020
Current Assets								
Cash	46	33	49	50	50	54	62	67
A/R	27	39	41	37	38	39	39	36
Inventories	59	90	77	79	81	82	83	75
Prepaid Expenses	2	1	2	2	2	2	2	2
Total Current Assets	134	164	169	168	171	176	185	179
Net PP&E	871	1,213	1,327	1,319	1,312	1,304	1,297	1,290
Net Intangible assets	23	31	206	206	206	206	206	206
Goodwill	0	8	68	68	68	68	68	68
Total Assets	1,028	1,417	1,769	1,761	1,756	1,754	1,755	1,742
Current Liabilities								
Short-Term Debt	40	0	1	0	0	0	0	0
A/P	59	61	45	57	58	59	59	54
Accrued Expenses	11	24	30	23	23	24	24	22
Total Current Liabilities	110	85	77	79	81	83	83	76
Long Term Debt	153	406	947	872	797	722	647	572
Shareholder's Equity	765	927	745	809	877	949	1,025	1,094
Total Liabilities & SE	1,028	1,417	1,769	1,761	1,756	1,754	1,755	1,742
Balance Check	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**

Income Statement	Historical			Forecasted Period				
	2013	2014	2015	2016	2017	2018	2019	2020
Revenues	932	873	839	911	933	946	953	866
COGS	(715)	(656)	(600)	(679)	(695)	(705)	(710)	(645)
Gross Profit	216	217	239	232	238	241	243	221
Operating Expenses:								
R&D	0	0	0	0	0	0	0	0
SG&A	(28)	(27)	(34)	(31)	(32)	(32)	(33)	(30)
D&A	(47)	(54)	(67)	(61)	(63)	(64)	(64)	(58)
EBIT	141	135	137	140	143	145	147	133
EBITDA	188	189	205	201	206	209	211	191
Net Interest	(15)	(37)	(48)	(54)	(49)	(45)	(40)	(36)
EBT	126	98	90	86	94	101	106	97
Less: Taxes	(69)	(44)	(12)	(33)	(36)	(38)	(40)	(37)
Net Income	57	54	77	54	58	62	66	60

Cash Flow Statement	Historical			Forecasted Period				
	2013	2014	2015	2016	2017	2018	2019	2020
Cash from Operating Activities								
Net Income	57	54	77	54	58	62	66	60
D&A	47	54	67	61	63	64	64	58
Changes in NWC:								
(Increase)/Decrease in A/R	-	(13)	(2)	4	(1)	(1)	(0)	4
(Increase)/Decrease in Inventories	-	(31)	13	(2)	(2)	(1)	(1)	8
(Increase)/Decrease in Prepaid Expenses	-	1	(1)	0	(0)	(0)	(0)	0
Increase/(Decrease) in A/P	-	2	(16)	11	1	1	0	(5)
Increase/(Decrease) in Accrued Expenses	-	13	7	(8)	1	0	0	(2)
Net Cash from Operations	104	80	146	121	120	125	130	122
Cash from Investing Activities								
Capital Expenditures	(46)	(68)	(42)	(54)	(55)	(56)	(56)	(51)
Net Cash from Investing	(46)	(68)	(42)	(54)	(55)	(56)	(56)	(51)
Cash from Financing Activities								
Issuance/(Repayment) of Debt				(75)	(75)	(75)	(75)	(75)
Dividend Issuance	(120)	(96)	(108)	(108)	(108)	(108)	(108)	(108)
Issuance/(Buyback) of Stock				117	117	117	117	117
Net Cash from Financing				(66)	(66)	(66)	(66)	(66)
Net Change in Cash				2	(0)	4	8	5

Appendix III - B : 3-Statement Projection Schedules & DCF

Income Statement Assumptions	Historical			Forecasted Period				
	2013	2014	2015	2016	2017	2018	2019	2020
Rev YoY Growth % (Bottom Up Proj. Sched)	-	-6%	-4%	9%	2%	1%	1%	-9%
COGS % of Rev.	77%	75%	72%	74%	74%	74%	74%	74%
R&D % of Sales	0%	0%	0%	0%	0%	0%	0%	0%
SG&A % of Sales	3%	3%	4%	3%	3%	3%	3%	3%
D&A % of Capex	101%	80%	159%	114%	114%	114%	114%	114%
Effective Tax Rate %	55%	45%	14%	38%	38%	38%	38%	38%
(CF) Capex % of Sales	5%	8%	5%	6%	6%	6%	6%	6%
Cost of Debt	6%	6%	6%	6%	6%	6%	6%	6%

Balance Sheet Assumptions	Historical			Forecasted Period				
	2013	2014	2015	2016	2017	2018	2019	2020
A/R Days of Rev.	10	16	18	15	15	15	15	15
Inventory Turnover Days of COGS	30	50	47	42	42	42	42	42
Prepaid Expenses % of Sales	0.2%	0.1%	0.2%	0.2%	0.2%	0.2%	0.2%	0.2%
A/P Days of COGS	30	34	28	31	31	31	31	31
Accrued Expenses % of Sales	1%	3%	4%	2%	2%	2%	2%	2%

Discounted Cash Flow Details

	2013A	2014A	2015A	2016E	2017E	2018E	2019E	2020E
Domestic Coke	919	824	764	806	806	806	806	715
Coal Logistics	14	55	81	114	138	152	159	163
Corporate and Other	(1)	(6)	(7)	(9)	(11)	(12)	(12)	(12)
Total Revenue	932	873	839	911	933	946	953	866
Cost Of Goods Sold	(715)	(656)	(600)	(679)	(695)	(705)	(710)	(645)
Gross Profit	216	217	239	232	238	241	243	221
Selling General & Admin Exp.	(28)	(27)	(31)	(31)	(32)	(32)	(33)	(30)
R & D Exp.	0	0	0	0	0	0	0	0
Depreciation & Amort.	(47)	(54)	(63)	(61)	(63)	(64)	(64)	(58)
Other Operating Expense/(Income)	0	0	0	0	0	0	0	0
EBIT	141	135	145	140	143	145	147	133
Less: Taxes	(53)	(51)	(54)	(33)	(36)	(38)	(40)	(37)
Less: Increase in NWC	14	(28)	1	6	(1)	(1)	(0)	4
Less: Capex	(46)	(68)	(42)	(54)	(54)	(55)	(56)	(56)
Add: Depr. & Amort.	47	53	59	61	63	64	64	58
UFCF	103	42	108	121	116	115	114	102
PV of CF	-	-	-	111	97	88	80	66
PV of Terminal Value (Multiples)	-	-	-	-	-	-	-	1000
PV of Terminal Value (GGM)	-	-	-	-	-	-	-	1001
Implied EV (Multiples)	1442							
Implied EV (GGM)	1443							

WACC Calculation	
Cost of Debt	5.9%
Cost of Equity	16%
Weight of Debt	54%
Weight of Equity	46%
Tax Rate	37.5%
WACC	9.2%
Terminal Value	
Terminal Multiple	8.1x
Terminal Value (Multiples)	1549
Gordon Growth Rate	2%
Terminal Value (GGM)	1551
EV=> Equity Value	
Implied EV (Multiples)	1442
Implied EV (GGM)	1443
Less: Net Debt	(771)
Less: Minority Interest	(39)
Implied MV (Multiples)	632
Implied MV (GGM)	633
Target Price (Multiples)	14
Target Price (GGM)	14