SUNOCO INC
Form 10-Q
May 07, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2004

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 1-6841

SUNOCO, INC.

(Exact name of registrant as specified in its charter)

PENNSYLVANIA	**23-1743282**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

TEN PENN CENTER, 1801 MARKET STREET, PHILADELPHIA, PA 19103-1699

(Address of principal executive offices)

(Zip Code)

(215) 977-3000

(Registrant s telephone number, including area code)

NOT APPLICABLE

(Former name, former address and former fiscal year, if changed since last report)

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 x NO ¨

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

At March 31, 2004, there were 75,569,836 shares of Common Stock, $1 par value outstanding.

SUNOCO, INC.

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PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Sunoco, Inc. and Subsidiaries

(Millions of Dollars and Shares Except Per Share Amounts)

	2004	2003*
	(UNAUDITED)	
REVENUES		
Sales and other operating revenue (including consumer excise taxes)	$ 5,232	$ 4,589
Interest income	2	2
Other income (Note 3)	11	5
	5,245	4,596
COSTS AND EXPENSES		
Cost of products sold and operating expenses	4,254	3,722
Consumer excise taxes	498	437
Selling, general and administrative expenses (Note 3)	187	163
Depreciation, depletion and amortization	100	85
Payroll, property and other taxes	33	27
Interest cost and debt expense	29	29
Interest capitalized	(1)	(1)
	5,100	4,462
Income before income tax expense	145	134
Income tax expense	56	48
NET INCOME	$ 89	$ 86
Net income per share of common stock:		
Basic	$ 1.18	$ 1.12
Diluted	$ 1.17	$ 1.12
Weighted average number of shares outstanding (Note 4):		
Basic	75.5	76.5
Diluted	76.3	77.1
Cash dividends paid per share of common stock	$ .275	$ .25

* Restated to reflect the consolidation of the Epsilon Products Company, LLC (Epsilon) polypropylene joint venture, effective January 1, 2003, in connection with the adoption of FASB Interpretation No. 46, Consolidation of Variable Interest Entities, in the first quarter of 2004 (Note 2).

(See Accompanying Notes)

CONDENSED CONSOLIDATED BALANCE SHEETS

Sunoco, Inc. and Subsidiaries

(Millions of Dollars)	At March 31 2004 (UNAUDITED)	At December 31 2003*
ASSETS		
Current Assets		
Cash and cash equivalents	$ 311	$ 431
Accounts and notes receivable, net	1,171	1,056
Inventories:		
Crude oil	401	150
Petroleum and chemical products	380	223
Materials, supplies and other	117	121
Deferred income taxes	89	91
Total Current Assets	2,469	2,072
Investments and long-term receivables	148	143
Properties, plants and equipment	8,232	8,132
Less accumulated depreciation, depletion and amortization	3,775	3,727
Properties, plants and equipment, net	4,457	4,405
Prepaid retirement costs	11	11
Deferred charges and other assets (Note 5)	412	422
Total Assets	$ 7,497	$ 7,053
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 1,784	$ 1,365
Accrued liabilities (Note 6)	389	435
Short-term borrowings (Note 7)	100	
Current portion of long-term debt (Note 7)	67	103
Taxes payable	219	242
Total Current Liabilities	2,559	2,145
Long-term debt	1,434	1,498
Retirement benefit liabilities (Note 8)	605	604
Deferred income taxes	632	602
Other deferred credits and liabilities (Note 6)	230	208
Commitments and contingent liabilities (Note 6)		
Minority interests (Note 3)	421	440
Shareholders equity (Note 9)	1,616	1,556
Total Liabilities and Shareholders Equity	$ 7,497	$ 7,053

* Restated to reflect the consolidation of the Epsilon joint venture, effective January 1, 2003, in connection with the adoption of FASB Interpretation No. 46 in the first quarter of 2004 (Note 2).

(See Accompanying Notes)

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Sunoco, Inc. and Subsidiaries

(Millions of Dollars)

	For the Three Months Ended March 31	
	2004	2003*
	(UNAUDITED)	
INCREASES (DECREASES) IN CASH AND CASH EQUIVALENTS		
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 89	$ 86
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	100	85
Deferred income tax expense	35	39
Payments less than (in excess of) expense for retirement plans	1	(7)
Changes in working capital pertaining to operating activities, net of effect of acquisitions:		
Accounts and notes receivable	(115)	(175)
Inventories	(277)	46
Accounts payable and accrued liabilities	377	218
Taxes payable	(18)	75
Other	(4)	11
Net cash provided by operating activities	188	378
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(112)	(68)
Acquisitions, net of seller financing of $4 in 2003 (Note 5)	(235)	(194)
Proceeds from divestments (Note 5)	97	7
Other	1	(5)
Net cash used in investing activities	(249)	(260)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Net proceeds from short-term borrowings	100	
Proceeds from issuance of long-term debt	2	
Repayments of long-term debt	(102)	(9)
Cash distributions to investors in cokemaking operations	(19)	(20)
Cash dividend payments	(21)	(19)
Purchases of common stock for treasury	(37)	
Proceeds from issuance of common stock under management incentive and employee option plans	24	4
Other	(6)	(5)
Net cash used in financing activities	(59)	(49)
Net increase (decrease) in cash and cash equivalents	(120)	69
Cash and cash equivalents at beginning of period	431	390

Cash and cash equivalents at end of period	$ 311	$ 459

* Restated to reflect the consolidation of the Epsilon joint venture, effective January 1, 2003, in connection with the adoption of FASB Interpretation No. 46 in the first quarter of 2004 (Note 2).

(See Accompanying Notes)

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. General.

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, 2004 are not necessarily indicative of results for the full year 2004.

2. Principles of Consolidation.

The consolidated financial statements of Sunoco, Inc. and subsidiaries (collectively, Sunoco or the Company) contain the accounts of all entities that are controlled (generally more than 50 percent owned) and variable interest entities for which the Company is the primary beneficiary (see below). Corporate joint ventures and other investees over which the Company has the ability to exercise significant influence but that are not consolidated are accounted for by the equity method.

In January 2003, FASB Interpretation No. 46, Consolidation of Variable Interest Entities , was issued and subsequently revised in December 2003 (FASB Interpretation No. 46). Among other things, FASB Interpretation No. 46 defines a variable interest entity (VIE) as an entity that either has investor voting rights that are not proportional to their economic interests or has equity investors that do not provide sufficient financial resources for the entity to support its activities. FASB Interpretation No. 46 requires a VIE to be consolidated by a company if that company is the primary beneficiary. The primary beneficiary is the company that is subject to a majority of the risk of loss from the VIE s activities or, if no company is subject to a majority of such risk, the company that is entitled to receive a majority of the VIE s residual returns.

In connection with the adoption of FASB Interpretation No. 46 in the first quarter of 2004, Sunoco consolidated Epsilon Products Company, LLC (Epsilon) and restated its 2003 financial statements to conform to the 2004 presentation. Epsilon is a joint venture that consists of polymer-grade propylene operations at Sunoco s Marcus Hook, PA refinery and an adjacent polypropylene plant. The following is a summary of the impact of consolidating Epsilon on Sunoco s consolidated financial position at January 1, 2003 (in millions of dollars):

Increase(decrease) in:	
Current assets	$ 11
Investments and long-term receivables	(50)
Properties, plants and equipment, net	132
Deferred charges and other assets	49
Current liabilities	(21)
Long-term debt	155
Minority interests	8

Epsilon s long-term debt at January 1, 2003 was comprised of $120 million of floating-rate notes, which are collateralized by the joint venture s polypropylene facility, and $35 million outstanding under Epsilon s $40 million revolving credit facility. Sunoco, Inc. guarantees 100 percent of these borrowings.

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The consolidation of Epsilon did not impact Sunoco s net income or have a significant effect on any amounts in its condensed consolidated statements of income for the three-month periods ended March 31, 2004 and 2003.

3. Minority Interests.

Cokemaking Operations

Since 1995, Sunoco has received $724 million in exchange for interests in its Indiana Harbor and Jewell cokemaking operations in four separate transactions. Sunoco did not recognize any gain at the dates of these transactions as the third-party investors are entitled to a preferential return on their investments, currently equal to 98 percent of the cash flows and tax benefits from the respective cokemaking operations, during the preferential return periods which continue until they recover their investments and achieve a cumulative after-tax return that averages approximately 10 percent. Income is recognized as coke production and sales generate cash flows and tax benefits which are allocated to Sunoco and the third-party investors, while expense is recognized to reflect the investors preferential returns.

The preferential return period for the Jewell operation is expected to end in 2011, while the preferential return period for the Indiana Harbor operation is expected to end in 2007. The estimated lengths of these preferential return periods are based upon the Company s current expectations of future operations, including sales volumes and prices, raw material and operating costs and capital expenditure levels. Better-than-expected results will shorten the investors preferential return periods, while lower-than-expected results will lengthen the periods.

After these preferential return periods, the investor in the Jewell operation will be entitled to a minority interest in the cash flows and tax benefits from Jewell amounting to 18 percent, while the investors in the Indiana Harbor operation will be entitled to a minority interest in the cash flows and tax benefits from Indiana Harbor initially amounting to 34 percent and declining to 10 percent by 2038.

The following table sets forth the minority interest balances and the changes in these balances attributable to the third-party investors interests in cokemaking operations for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Three Months Ended March 31	
	2004	**2003**
Balance at beginning of year	$ 328	$ 379
Nonconventional fuel credit and other tax benefits*	(13)	(13)
Preferential return*	13	14
Cash distributions to third-party investors	(19)	(20)
Balance at end of period	$ 309	$ 360

* The nonconventional fuel credit and other tax benefits and the preferential return, which comprise the noncash change in the minority interest in cokemaking operations, are included in other income in the condensed consolidated statements of income.

In each of the four transactions in which the Company transferred interests in its cokemaking operations to third-party investors, Sunoco has provided tax indemnifications to the third parties for certain tax benefits allocated to them during the preferential return periods. In certain of these cases, the Company also has the option to purchase the third-party investors interests. These indemnifications would require the Company to make payments in the event the Internal Revenue Service disallows the tax deductions and benefits allocated to the third parties or if there is a change in the tax laws that reduces the amount of nonconventional fuel tax credits which would be available to them. These tax indemnifications are in effect until the applicable tax returns are no longer subject to Internal Revenue Service review. Although the Company believes it is remote that it will be required to make any payments under these indemnifications, at March 31, 2004, the maximum potential payment under the tax indemnifications and the options to purchase the third-party investors interests, if exercised, would have been approximately $775 million. If this were to occur, the minority interest balance would be reduced by approximately $270 million.

Logistics Operations

On February 8, 2002, the Company contributed a substantial portion of its Logistics business to Sunoco Logistics Partners L.P., a master limited partnership formed in 2001 (the Partnership), in exchange for a 73.2 percent limited partnership interest, a 2 percent general partnership interest, incentive distribution rights and a special distribution, representing the net proceeds from the Partnership s issuance of $250 million of ten-year 7.25 percent senior notes. The Partnership concurrently issued 5.75 million limited partnership units, representing a 24.8 percent interest in the Partnership, in an initial public offering at a price of $20.25 per unit. Proceeds from the offering were used by the Partnership to establish working capital that was not contributed to the Partnership by Sunoco. Sunoco liquidated this retained working capital subsequent to the Partnership s formation. The accounts of the Partnership continue to be included in Sunoco s consolidated financial statements. No gain or loss was recognized on this transaction.

Concurrent with the offering, Sunoco entered into various agreements with the Partnership which require Sunoco to pay for minimum storage and throughput usage of certain Partnership assets. These agreements also establish fees for administrative services provided by Sunoco to the Partnership and indemnifications by Sunoco for certain environmental, toxic tort and other liabilities.

The following table sets forth the minority interest balance and the changes to this balance attributable to the third-party investors interests in

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Sunoco Logistics Partners L.P. for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Three Months Ended March 31	
	2004	2003
Balance at beginning of year	$ 104	$ 100
Minority interest share of income*	3	5
Cash distributions to third-party investors**	(3)	(3)
Balance at end of period	$ 104	$ 102

* Included in selling, general and administrative expenses in the condensed consolidated statements of income.

** The Partnership increased its quarterly cash distribution per unit from $.45 to $.4875 for the fourth quarter of 2002 and then to $.50 for the second quarter of 2003, $.5125 for the third quarter of 2003, $.55 for the fourth quarter of 2003 and $.57 for the first quarter of 2004.

In April 2004, the Partnership issued 3.4 million limited partnership units under its effective shelf registration statement and redeemed 2.2 million limited partnership units owned by Sunoco. Upon completion of the offering and related redemption, Sunoco now has a 62.6 percent interest in the Partnership, including its 2 percent general partnership interest. Sunoco did not recognize any gain or loss on these transactions (Note 12).

4. Earnings Per Share Data.

The following table sets forth the reconciliation of the weighted average number of common shares used to compute basic earnings per share (EPS) to those used to compute diluted EPS for the three-month periods ended March 31, 2004 and 2003 (in millions):

	Three Months Ended March 31	
	2004	2003
Weighted average number of common shares outstanding basic	75.5	76.5
Add effect of dilutive stock incentive awards	.8	.6
Weighted average number of shares - diluted	76.3	77.1

5. Changes in Business.

Acquisitions

Eagle Point Refinery and Related Assets Effective January 13, 2004, Sunoco completed the purchase of the 150 thousand barrels-per-day Eagle Point refinery and related assets from El Paso Corporation for $235 million, including inventory. In connection with this transaction, Sunoco assumed certain environmental and other liabilities. The Eagle Point refinery is located in Westville, NJ, near the Company s existing Northeast refining operations. Management believes the acquisition of the Eagle Point refinery complements and enhances the Company s refining operations in the Northeast and enables the capture of significant synergies in the larger Northeast Refining Complex. The related assets acquired include certain pipeline and other logistics assets associated with the refinery which Sunoco sold to Sunoco Logistics Partners L.P. in March 2004 (Note 12).

The purchase price has been tentatively allocated to the assets acquired and liabilities assumed based on their relative fair market values at the acquisition date. The following is a summary of the effects of the transaction on Sunoco s consolidated financial position as of the acquisition date (in millions of dollars):

Increase in:	
Inventories	$ 152
Properties, plants and equipment, net	100
Accrued liabilities	(3)
Other deferred credits and liabilities	(14)
Cash paid on acquisition date	$ 235

In the first quarter of 2004, El Paso informed Sunoco that it disagrees with Sunoco s computation of the total amount due for inventory purchased in connection with the Eagle Point refinery acquisition. Sunoco believes its estimated payment for inventory on the acquisition date included a $5 million overpayment, while El Paso believes that Sunoco should pay El Paso an additional $26 million. Sunoco believes its interpretation of the contractual obligation is correct and is attempting to resolve this dispute. Changes in the payment for inventory would be treated as an adjustment to the purchase price for the acquisition.

Service Stations In the second quarter of 2003, Sunoco completed the purchase of 193 Speedway® retail gasoline sites from a subsidiary of Marathon Ashland Petroleum LLC for $162 million, including inventory. The sites, which are located primarily in Florida and South Carolina, are all Company-operated locations with convenience stores. Of the 193 outlets, Sunoco became lessee for 54 of the sites under long-term lease agreements. The Speedway® sites are being re-branded as Sunoco® locations in the 2003-2004 period. The Company believes this acquisition fits its long-term strategy to build a retail and convenience store network that will provide attractive long-term returns.

The purchase price has been allocated to the assets acquired and liabilities assumed based on their relative estimated fair market values at the acquisition date. The following is a summary of the effects of this transaction on Sunoco s consolidated financial position as of the acquisition date (in millions of dollars):

Increase in:	
Inventories	$ 21
Properties, plants and equipment, net	143
Other deferred credits and liabilities	(2)
Cash paid on acquisition date	$ 162

In conjunction with Sunoco s retail portfolio management activities, in 2004, Sunoco intends to sell its ownership interest in approximately 50 of the Speedway® sites and convert them to distributor outlets that will market under the Sunoco® brand. During the first four months of 2004, 19 of these sites have been sold.

Transaction with Equistar Chemicals, L.P. - Effective March 31, 2003, Sunoco formed a limited partnership with Equistar Chemicals, L.P. (Equistar) involving Equistar s ethylene facility in LaPorte, TX. Equistar is a joint venture between Lyondell Chemical Company and Millennium Chemicals Inc. In connection with this transaction, Equistar and the new partnership entered into a 700 million pounds-per-year, 15-year propylene supply contract with Sunoco. Of this amount, 500 million pounds per year is priced on a cost-

based formula that includes a fixed discount that declines over the life of the contract, while the remaining 200 million pounds per year is based on market prices. Sunoco also purchased Equistar s polypropylene facility in Bayport, TX. Sunoco paid $194 million in cash and borrowed $4 million from the seller to form the partnership and acquire the Bayport facility.

Through the new partnership, the Company believes it has secured a favorable long-term supply of propylene for its Gulf Coast polypropylene business, while the acquisition of the Bayport facility has increased the Company s polypropylene capacity. This transaction complements and enhances the Company s polypropylene business and strengthens its market position.

The purchase price has been allocated to the assets acquired and liabilities assumed based on their relative fair market values at the acquisition date. The following is a summary of the effects of the transaction on Sunoco s consolidated financial position as of the date of the transaction (in millions of dollars):

Increase in:	
Inventories	$ 11
Properties, plants and equipment, net	30
Deferred charges and other assets	160*
Accrued liabilities	(2)
Retirement benefit liabilities	(1)
	198
Seller financing:	
Current portion of long-term debt	(1)
Long-term debt	(3)
	(4)
Cash paid on acquisition date	$ 194

* Represents the amounts allocated to the propylene supply contract and the related partnership. The Company will amortize this deferred cost into income over the 15-year life of the supply contract in a manner that reflects the future decline in the fixed discount over the contract period. This amortization expense amounted to $4 million in the three months ended March 31, 2004. The unamortized cost related to the supply contract and related partnership amounted to $145 million at March 31, 2004.

Pro Forma Data for Acquisitions - The unaudited pro forma sales and other operating revenue, net income and net income per share of common stock of Sunoco, as if the acquisition of the Eagle Point refinery and related assets, the 193 Speedway® outlets and the Bayport polypropylene facility had occurred on January 1, 2003, are as follows (in millions of dollars, except per share amounts):

	Three Months Ended March 31	
	2004	2003
Sales and other operating revenue	$ 5,309	$ 5,336

Net income	$ 91	$ 109
Net income per share of common stock diluted	$ 1.19	$ 1.41

The pro forma amounts above do not include any effects attributable to the propylene supply contract or the related partnership with Equistar since the supply contract did not exist prior to the transaction date.

The pro forma information does not purport to be indicative of the results that actually would have been obtained if the Eagle Point refinery and related assets, the 193 Speedway® outlets and the Bayport polypropylene facility had been part of Sunoco s businesses during the periods presented and is not intended to be a projection of future results. Accordingly, the pro forma results do not reflect any restructuring costs, changes in operating levels, or potential cost savings and other synergies.

Plasticizer Business Divestment

During the fourth quarter of 2003, Sunoco announced its decision to sell its plasticizer business and in that period recorded a $23 million provision ($15 million after tax) to write down the assets held for sale to their estimated fair values less costs to sell and established a $5 million accrual ($2 million after tax) for employee terminations under a postemployment plan and for other required exit costs. Sunoco sold this business and related inventory in January 2004 to BASF for approximately $90 million in cash. The sale included the Company s plasticizer facility in Pasadena, TX. The Company s Neville Island, PA, site was not part of the transaction and will continue to produce plasticizers exclusively for BASF under a three-year tolling agreement. Sunoco also agreed to provide terminalling services at this facility to BASF for a 15-year period.

6. Commitments and Contingent Liabilities.

Sunoco is contingently liable under various arrangements that guarantee debt of third parties aggregating to approximately $12 million at March 31, 2004. At this time, management does not believe that it is likely that the Company will have to perform under any of these guarantees.

Over the years, Sunoco has sold thousands of retail gasoline outlets as well as refineries, terminals, coal mines, oil and gas properties and various other assets. In connection with these sales, the Company has indemnified the purchasers for potential environmental and other contingent liabilities related to the period prior to the transaction dates. In most cases, the effect of these arrangements was to afford protection for the purchasers with respect to obligations for which the Company was already primarily liable. While some of these indemnities have spending thresholds, which must be exceeded before they become operative, or limits on Sunoco s maximum exposure, they generally are not limited. The Company accrues for any obligations under these agreements when a loss is probable and reasonably estimable. The Company cannot reasonably estimate the maximum potential amount of future payments under these agreements.

Sunoco is subject to extensive and frequently changing federal, state and local laws and regulations, including, but not limited to, those relating to the discharge of materials into the environment or that otherwise deal with the protection of the environment, waste management and the characteristics and composition of fuels. As with the industry generally, compliance with existing and anticipated laws and regulations increases the overall cost of operating Sunoco s businesses, including the capital costs to construct, maintain and upgrade equipment and facilities. Existing laws and regulations result in liabilities and loss contingencies for remediation at Sunoco s facilities and at third-party or formerly owned sites. The accrued liability for environmental remediation is classified in the condensed consolidated balance sheets as follows (in millions of dollars):

	At March 31 2004	At December 31 2003
Accrued liabilities	$ 38	$ 44
Other deferred credits and liabilities	117	102
	$ 155	$ 146

The following table summarizes the changes in the accrued liability for environmental remediation activities by category for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Refineries	Marketing Sites	Chemicals Facilities	Pipelines and Terminals	Hazardous Waste Sites	Other	Total
Balance at January 1, 2003	$ 52	$ 72	$ 8	$ 19	$ 5	$ 3	$ 159
Accruals		5		1	1		7
Payments	(2)	(3)		(2)	(1)		(8)
Balance at March 31, 2003	$ 50	$ 74	$ 8	$ 18	$ 5	$ 3	$ 158
Balance at January 1, 2004	$ 43	$ 74	$ 7	$ 15	$ 5	$ 2	$ 146
Accruals		4					4
Payments	(2)	(4)		(1)	(1)		(8)
Acquisitions and divestments	11		(1)				10
Other*	2	1					3
Balance at March 31, 2004	$ 54	$ 75	$ 6	$ 14	$ 4	$ 2	$ 155

* Consists of increases in the accrued liability for which recovery from third parties is probable.

Sunoco s accruals for environmental remediation activities reflect its estimates of the most likely costs that will be incurred over an extended period to remediate identified conditions for which the costs are both probable and reasonably estimable. Engineering studies, historical experience and other factors are used to identify and evaluate remediation alternatives and their related costs in determining the estimated accruals for environmental remediation activities. Losses attributable to unasserted claims are also reflected in the accruals to the extent they are probable of occurrence and reasonably estimable.

Total future costs for the environmental remediation activities identified above will depend upon, among other things, the identification of any additional sites, the determination of the extent of the 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 terms of cost sharing arrangements with other potentially responsible parties, the availability of insurance coverage, the nature and extent of future environmental laws, inflation rates and the determination of Sunoco s liability at the sites, if any, in light of the number, participation level and financial viability of the other parties. Management believes it is reasonably possible (i.e., less than probable but greater than remote) that additional environmental remediation losses will be incurred. At March 31, 2004, the aggregate of the estimated maximum additional reasonably possible losses, which relate to numerous individual sites, totaled $105 million. However, the Company believes it is very unlikely that it will realize the maximum loss at every site. Furthermore, the recognition of additional losses, if and when they were to occur, would likely extend over many years and, therefore, likely would not have a material impact on the Company s financial position.

Under various environmental laws, including the Resource Conservation and Recovery Act (RCRA) (which relates to solid and hazardous waste treatment, storage and disposal), Sunoco has initiated corrective remedial action at its facilities, formerly owned facilities and third-party sites. At the Company s major manufacturing facilities, Sunoco has consistently assumed continued industrial use and a containment/remediation strategy focused on eliminating unacceptable risks to human health or the environment. The remediation accruals for these sites reflect that strategy. Accruals include amounts to prevent off-site migration and to contain the impact on the facility property, as well as to address known, discrete areas requiring remediation within the plants. Activities include closure of RCRA solid waste management units, recovery of hydrocarbons, handling of impacted soil, mitigation of surface water impacts and prevention of off-site migration.

Many of Sunoco s current terminals are being addressed with the above containment/remediation strategy. At some smaller or less impacted facilities and some previously divested terminals, the focus is on remediating discrete interior areas to attain regulatory closure.

Sunoco owns or operates certain retail gasoline outlets where releases of petroleum products have occurred. Federal and state laws and regulations require that contamination caused by such releases at these sites and at formerly owned sites be assessed and remediated to meet the applicable standards. The obligation for Sunoco to remediate this type of contamination varies, depending on the extent of the release and the applicable laws and regulations. A portion of the remediation costs may be recoverable from the reimbursement fund of the applicable state, after any deductible has been met.

Future costs for environmental remediation activities at the Company s marketing sites also will be influenced by the extent of MTBE contamination of groundwater aquifers, the cleanup of which will be driven by thresholds based on drinking water protection. Though not all groundwater is used for drinking, several states have initiated or proposed more stringent MTBE cleanup requirements. Cost increases result directly from extended remedial operations and maintenance on sites that, under prior standards, could otherwise have been completed, installation of additional remedial or monitoring wells and purchase of more expensive equipment because of the presence of MTBE. While actual cleanup costs for specific sites are variable and depend on many of the factors discussed above, expansion of similar MTBE remediation thresholds to additional states or adoption of even more stringent requirements for MTBE remediation would result in further cost increases.

The accrued liability for hazardous waste sites is attributable to potential obligations to remove or mitigate the environmental effects of the disposal or release of certain pollutants at third-party sites pursuant to the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) (which relates to releases and remediation of hazardous substances) and similar state laws. Under CERCLA, Sunoco is potentially subject to joint and several liability for the costs of remediation at sites at which it has been identified as a potentially responsible party (PRP). As of March 31, 2004, Sunoco had been named as a PRP at 47 sites identified or potentially identifiable as Superfund sites under federal and state law. The Company is usually one of a number of companies identified as a PRP at a site. Sunoco has reviewed the nature and extent of its involvement at each site and other relevant circumstances and, based upon the other parties involved or Sunoco s negligible participation therein, believes that its potential liability associated with such sites will not be significant.

Management believes that none of the current remediation locations, which are in various stages of ongoing remediation, is individually material to Sunoco as its largest accrual for any one Superfund site, operable unit or remediation area was less than $6 million at March 31, 2004. As a result, Sunoco s exposure to adverse developments with respect to any individual site is not expected to be material. However, if changes in environmental regulations occur, such changes could impact multiple Sunoco facilities and formerly owned and third-party sites at the same time. As a result, from time to time, significant charges against income for environmental remediation may occur.

The Company maintains insurance programs that cover certain of its existing or potential environmental liabilities, which programs vary by year, type and extent of coverage. For underground storage tank remediations, the Company can also seek reimbursement through various state funds of certain remediation costs above a deductible amount. For certain acquired properties, the Company has entered into arrangements with the sellers or others that allocate environmental liabilities and provide indemnities to the Company for remediating contamination that occurred prior to the acquisition dates. Some of these environmental indemnifications are subject to caps and limits. No accruals have been recorded for any potential contingent liabilities that will be funded by the prior owners as management does not believe, based on current information, that it is likely that any of the former owners will not perform under any of these agreements. Other than the preceding arrangements, the Company has not entered into any arrangements with third parties to mitigate its exposure to loss from environmental contamination. Claims for recovery of environmental liabilities that are probable of realization totaled $23 million at March 31, 2004 and are included in deferred charges and other assets in the condensed consolidated balance sheets.

In December 1999, the U.S. Environmental Protection Agency (EPA) adopted a rule under the Clean Air Act (which relates to emissions of materials into the air). This rule phases in limitations on the sulfur content of gasoline beginning in 2004. In January 2001, the EPA adopted another rule which will require limitations on the allowable sulfur content of on-road diesel fuel beginning in 2006. The rules include banking and trading credit systems, which could provide refiners flexibility until 2006 for the low-sulfur gasoline and until 2010 for the on-road low-sulfur diesel. These rules are expected to have a significant impact on Sunoco and its operations, primarily with respect to the capital and operating expenditures at its five current refineries. Most of the capital spending is likely to occur in the 2004-2006 period, while the higher operating costs will be incurred when the low-sulfur fuels are produced. The Company estimates that the total capital outlays to comply with the new gasoline and diesel requirements will be in the range of $400-$500 million, including amounts attributable to the recently acquired Eagle Point refinery. Spending to meet these requirements totaled $36 million through March 31, 2004. The ultimate impact of the rules may be affected by such factors as technology selection, the effectiveness of the systems pertaining to banking and trading credits, timing uncertainties created by permitting requirements and construction schedules and any effect on prices created by changes in the level of gasoline and diesel fuel production.

In April 2002, the EPA issued regulations implementing Phase II of the petroleum refinery Maximum Achievable Control Technology (MACT II) rule under the Clean Air Act. This rule regulates emissions of hazardous air pollutants (including organics, reduced sulfur compounds, inorganics and particulate metals) from certain sources at petroleum refineries, including catalytic cracking and reforming units and sulfur recovery units. The rule requires all petroleum refineries that are major sources of hazardous air pollutants to meet emission standards reflecting the application of the maximum achievable control technology at the affected sources by April 2005. Analysis of this rule to determine its impact is ongoing. Although the ultimate impact of the rule cannot be determined at this time, it could have a significant impact on Sunoco and its operations, primarily with respect to capital expenditures at its refineries.

In July 1997, the EPA promulgated new, more stringent National Ambient Air Quality Standards for ozone and fine particles, which is resulting in identification of non-attainment areas throughout the country, including Texas, Pennsylvania, Ohio and West Virginia, where Sunoco operates facilities. The EPA issued final ozone non-attainment area designations in April 2004, which become effective June 15, 2004. Fine particle non-attainment areas are not expected to be designated until early 2005. These standards will result in further controls of both nitrogen oxide and volatile organic compound emissions. Regulatory programs, when established to implement the new standards, could have an impact on Sunoco and its operations. However, the potential financial impact cannot be reasonably estimated until the EPA completes the non-attainment area designation process and promulgates regulatory programs to attain the standards, and the states, as necessary, develop and implement revised State Implementation Plans to respond to the new regulations.

Since the late 1990s, the EPA has undertaken significant enforcement initiatives under authority of the Clean Air Act, targeting industries with large manufacturing facilities that are significant sources of emissions, including the refining industry. The EPA has asserted that many of these facilities have modified or expanded their operations over time without complying with New Source Review regulations that require permits and new emission controls in connection with any significant facility modifications or expansions that could increase emissions above certain thresholds, and have violated various other provisions of the Clean Air Act, including the New Source Review and Prevention of Significant Deterioration (NSR/PSD) Program, Benzene Waste Operations National Emissions Standards for Hazardous Air Pollutants (NESHAP), Leak Detection and Repair (LDAR) and flaring requirements. As part of this enforcement initiative, the EPA has entered into consent agreements with several refiners that require them to pay civil fines and penalties and make significant capital expenditures to install emissions control equipment at selected facilities. For some of these refineries, the cost of the required emissions control equipment is significant, depending on the size, age and configuration of the refinery. Sunoco received information requests in 2000, 2001 and 2002 in connection with the enforcement initiative pertaining to its Marcus Hook, Philadelphia, Toledo and Tulsa refineries, the Puerto Rico refinery divested in 2001 and its phenol facility in Philadelphia, PA. Sunoco has completed its responses to the EPA. In 2003, Sunoco received an additional information request pertaining to its phenol plant in Philadelphia.

Sunoco has received Notices of Violation and Findings of Violation from the EPA relating to its Marcus Hook, Philadelphia and Toledo refineries. The Notices and Findings of Violation allege failure to comply with certain requirements relating to benzene wastewater emissions at the Company s Marcus Hook, Toledo and Philadelphia refineries and failure to comply with certain requirements relating to leak detection and repair at the Toledo refinery. In addition, the EPA has alleged that: at the Company s Philadelphia refinery, certain modifications were made to one of the fluid catalytic cracking units in 1992 and 1998 without obtaining requisite permits; at the Company s Marcus Hook refinery, certain modifications were made to the fluid catalytic cracking unit in 1990 and 1996 without obtaining requisite permits; and at the Company s Toledo refinery, certain physical and operational changes were made to the fluid catalytic cracking unit in 1985 without obtaining requisite permits. The EPA has also alleged that at the Company s Toledo refinery, certain physical and operational changes were made to the sulfur plant in 1995, 1998 and 1999 without obtaining requisite permits; certain physical and operational changes were made to a flare system without obtaining requisite permits; and that the flare system was not being operated in compliance with the Clean Air Act. Sunoco has met with representatives of the EPA on these Notices and Findings of Violation and is currently evaluating its position. Although Sunoco does not believe that it has violated any Clean Air Act requirements, as part of this initiative, Sunoco could be required to make significant capital expenditures, incur higher operating costs, operate these refineries at reduced levels and pay significant penalties. There were no liabilities accrued at March 31, 2004 in connection with this initiative. With respect to the Company s recently acquired Eagle Point refinery, El Paso Corporation, its prior owner, has entered into a consent decree with the EPA and the New Jersey Department of Environmental Protection as part of the EPA s enforcement initiative. Sunoco does not anticipate substantial capital expenditures on its part as a result of El Paso s consent decree.

Energy policy legislation continues to be debated in the U.S. Congress. The Bush Administration and the U.S. Senate and U.S. House have been unable to reach agreement on final legislation. There are numerous issues being debated, including an MTBE phaseout, ethanol and MTBE safe harbor liability provisions, ethanol and renewal fuels mandates and other issues that could impact gasoline production. Sunoco uses MTBE and ethanol as oxygenates in different geographic areas of its refining and marketing system. While federal action is uncertain, California, New York and Connecticut began enforcing state-imposed MTBE bans on January 1, 2004. Sunoco does not market in California but is complying with the bans in New York and Connecticut. These bans have resulted in unique gasoline blends, which could have a significant impact on market conditions depending on the details of future regulations, the impact on gasoline supplies, the cost and availability of ethanol and alternate oxygenates if the minimum oxygenate requirements remain in effect, and the ability of Sunoco and the industry in general to recover their costs in the marketplace. A number of additional states, including some in the northeastern United States, have legislative and administrative actions underway that could lead to MTBE bans by 2007.

Sunoco, along with other refiners, manufacturers and sellers of gasoline, owners and operators of retail gasoline sites, and manufacturers of MTBE, are defendants in over 60 cases in 17 states involving the manufacture and use of MTBE in gasoline and MTBE contamination in groundwater. Plaintiffs, which include private litigants, governments and quasi-governmental entities, including various water authorities and towns, and the State of New Hampshire, allege that refiners and suppliers of gasoline containing MTBE are responsible for manufacturing and distributing a defective product. Plaintiffs also generally are alleging groundwater contamination, nuisance, trespass, negligence, failure to warn, violation of environmental laws and deceptive business practices. Plaintiffs are seeking compensatory damages, and in some cases injunctive relief and punitive damages. Most of the cases have been removed to federal court by motion of the defendants and consolidated for pretrial purposes in the U.S. District Court for the Southern District of New York. Motions to remand these cases to their respective state courts are pending. Up to this point, for the group of MTBE cases currently pending, there has been little information developed about the plaintiffs legal theories or the facts that would be relevant to an analysis of potential exposure. Based on the current law and facts available at this time, Sunoco believes that these cases will not have a material adverse effect on its consolidated financial position.

Many other legal and administrative proceedings are pending or possible against Sunoco from its current and past operations, including proceedings related to commercial and tax disputes, product liability, antitrust, employment claims, leaks from pipelines and underground storage tanks, natural resource damage claims, premises-liability claims, allegations of exposures of third parties to toxic substances (such as benzene or asbestos) and general environmental claims. The ultimate outcome of these proceedings and the matters discussed above cannot be ascertained at this time; however, it is reasonably possible that some of them could be resolved unfavorably to Sunoco. Management believes that these matters could have a significant impact on results of operations for any future quarter or year. However, management does not believe that any additional liabilities which may arise pertaining to such matters would be material in relation to the consolidated financial position of Sunoco at March 31, 2004. Furthermore, management does not believe that the overall costs for environmental activities will have a material impact over an extended period of time on Sunoco s cash flows or liquidity.

7. Debt Refinancing.

In the first quarter of 2004, the Company issued $100 million of commercial paper and used the proceeds to repay its $100 million of 7 $^{1}/8$ percent notes that were due in March 2004.

8. Retirement Benefit Plans.

The following sets forth the components of defined benefit plans and postretirement benefit plans expense for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Defined Benefit Plans		**Postretirement Benefit Plans**	
	Three Months Ended March 31		**Three Months Ended March 31**	
	2004	**2003**	**2004**	**2003**
Service cost (cost of benefits earned during the year)	$ 11	$ 9	$ 2	$ 2
Interest cost on benefit obligations	21	22	6	6
Expected return on plan assets	(20)	(20)		
Amortization of:				
Prior service cost (benefit)	1	1	(2)	(3)
Unrecognized losses	8	5	1	1
	$ 21	$ 17	$ 7	$ 6

In the fourth quarter of 2003, Congress passed the Medicare Prescription Drug Act of 2003. As permitted, no accounting recognition has been given to this new legislation because authoritative accounting guidance has not yet been issued and the Company cannot reasonably estimate its impact at this time.

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9. Shareholders Equity.

	At March 31 2004	At December 31 2003
	(Millions of Dollars)	
Common stock, par value $1 per share	$ 138	$ 137
Capital in excess of par value	1,586	1,552
Earnings employed in the business	2,444	2,376
Accumulated other comprehensive loss	(189)	(187)
Common stock held in treasury, at cost	(2,363)	(2,322)
Total	$ 1,616	$ 1,556

10. Comprehensive Income.

The following table sets forth Sunoco s comprehensive income for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Three Months Ended March 31 2004	Three Months Ended March 31 2003
Net income	$ 89	$ 86
Other comprehensive income:		
Net hedging gains (net of related tax expense of $1 in 2004 and $2 in 2003)	2	4
Reclassifications of net hedging gains to earnings (net of related tax benefit of $2 in 2004 and $4 in 2003)	(4)	(7)
Comprehensive income	$ 87	$ 83

11. Business Segment Information.

The following table sets forth certain income statement information concerning Sunoco s business segments for the three-month periods ended March 31, 2004 and 2003 (in millions of dollars):

	Sales and Other Operating Revenue		
Three Months Ended March 31, 2004	**Unaffiliated Customers**	**Inter-segment**	**Segment Income (Loss) (after tax)**
Refining and Supply	$ 2,326	$ 1,437	$ 100
Retail Marketing	2,018		(4)
Chemicals	445		12
Logistics	379	365	8
Coke	64		9
Corporate and Other			(36)*
Consolidated	$ 5,232		$ 89
Three Months Ended March 31, 2003			
Refining and Supply	$ 1,976	$ 1,206	$ 93
Retail Marketing	1,758		10
Chemicals	430**		(4)
Logistics	362	354	11
Coke	63		10
Corporate and Other			(34)***
Consolidated	$ 4,589		$ 86

* Consists of $12 million of after tax corporate expenses and $24 million of after-tax net financing expenses and other.

** Restated to reflect the consolidation of the Epsilon joint venture in connection with the adoption of FASB Interpretation No. 46 in the first quarter of 2004 (Note 2).

*** Consists of $9 million of after-tax corporate expenses and $25 million of after-tax net financing expenses and other.

The following table sets forth Sunoco s total assets by business segment at March 31, 2004 (in millions of dollars):

Refining and Supply	$ 2,902
Retail Marketing	1,278
Chemicals	1,500
Logistics	1,222
Coke	277
Corporate and Other	376*

Consolidated	$ 7,497**

* Consists of Sunoco s $89 million consolidated deferred income tax asset, $11 million of prepaid retirement costs and $276 million attributable to corporate activities.

** After elimination of intersegment receivables.

12. Subsequent Events.

In April 2004, Sunoco Logistics Partners L.P. issued 3.4 million limited partnership units under its effective shelf registration statement at a price of $39.75 per unit. Proceeds from the offering totaled approximately $129 million net of underwriting discounts and offering expenses. Coincident with the offering, the Partnership redeemed for $83 million, 2.2 million limited partnership units owned by Sunoco. Upon completion of the offering and related redemption of Sunoco s limited partnership units, Sunoco now has a 62.6 percent interest in the Partnership, including its 2 percent general partnership interest. The accounts of the Partnership continue to be included in Sunoco s consolidated financial statements. No gain or loss was recognized on these transactions. The proceeds from the offering were also used by the Partnership to finance the $20 million acquisition in March 2004 of certain pipeline and other logistics assets previously purchased by Sunoco with the Eagle Point refinery (Note 5) and the $12 million purchase in April 2004 of two ConocoPhillips refined product terminals located in Baltimore, MD and Manassas, VA. The logistics assets sold to the Partnership by Sunoco consist of crude oil and refined product ship and barge docks; refined product truck racks; and a 4.5 mile refined product pipeline from the Eagle Point refinery to the origin of the Harbor Pipeline. No gain or loss was recognized on this transaction. In addition, the Partnership intends to use proceeds from the offering to purchase an interest in the Harbor Pipeline from El Paso Corporation for $7 million.

In April 2004, Sunoco completed the purchase of 340 retail outlets currently operated under the Mobil® brand from ConocoPhillips for $181 million, including inventory. Of the total sites acquired, 112 are owned in fee or subject to long-term leases, with average gasoline throughput of approximately 175 thousand gallons per month. The remaining network consists of supply for 34 contract dealer-owned and operated locations and 194 branded distributor sites. These outlets, which include 31 sites that are Company-operated and have convenience stores, are located primarily in Delaware, Maryland, Virginia and Washington, D.C. These sites will be rebranded to Sunoco® gasoline and APlus® convenience stores over time.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

RESULTS OF OPERATIONS

Earnings Profile of Sunoco Businesses (after tax)

	Three Months Ended March 31		
	2004	**2003**	**Variance**
	(Millions of Dollars)		
Refining and Supply	$ 100	$ 93	$ 7
Retail Marketing	(4)	10	(14)
Chemicals	12	(4)	16
Logistics	8	11	(3)
Coke	9	10	(1)
Corporate and Other:			
Corporate expenses	(12)	(9)	(3)
Net financing expenses and other	(24)	(25)	1
Consolidated net income	$ 89	$ 86	$ 3

Analysis of Earnings Profile of Sunoco Businesses

In the three-month period ended March 31, 2004, Sunoco earned $89 million, or $1.17 per share of common stock on a diluted basis, compared to $86 million, or $1.12 per share, for the first quarter of 2003.

The $3 million increase in net income in the first quarter of 2004 was primarily due to a $23 million income contribution from the Eagle Point refinery acquired on January 13, 2004, a $28 million increase in margins for wholesale fuel and chemical products and a $5 million income contribution associated with the propylene supply agreement with Equistar Chemicals, L.P. and sales from the Bayport, TX, polypropylene facility acquired from Equistar. Partially offsetting these positive factors were lower margins for retail gasoline ($14 million), higher expenses($26 million), including fuel and depreciation, lower chemicals sales volumes($8 million) and lower income from logistics operations($3 million).

Refining and Supply

	For the Three Months Ended March 31	
	2004	**2003**
Income (millions of dollars)	$ 100	$ 93
Wholesale margin* (per barrel):		
Total Refining and Supply	$ 5.68	$ 5.35
Northeast Refining Complex	$ 5.74	$ 5.68
MidContinent Refining Complex	$ 5.46	$ 4.59
Crude inputs as percent of crude unit rated capacity**	95	96
Throughputs***(thousands of barrels daily):		
Crude oil	824.6	700.2
Other feedstocks	65.6	57.6
Total throughputs	890.2	757.8
Products manufactured***(thousand of barrels daily):		
Gasoline	419.0	359.6
Middle distillates	285.1	238.1
Residual fuel	77.5	58.7
Petrochemicals	33.3	25.3
Lubricants	13.0	13.2
Other	96.0	93.5
Total production	923.9	788.4
Less: Production used as fuel in refinery operations	42.9	36.8
Total production available for sale	881.0	751.6

* Wholesale sales revenue less cost of crude oil, other feedstocks, product purchases and related terminalling and transportation divided by production available for sale.

** In January 2004, crude unit capacity increased from 730 to 890 thousands of barrels daily. This change reflects the acquisition of the 150 thousand barrels-per-day Eagle Point refinery effective January 13, 2004 and a 10 thousand barrels-per-day adjustment at the Toledo refinery reflecting the increased reliability and enhanced operations at this facility in recent years. The calculation of the crude inputs as a percent of crude unit rated capacity for the three months ended March 31, 2004 includes the Eagle Point refinery, effective January 13, 2004.

*** Data pertaining to the Eagle Point refinery for the three months ended March 31, 2004 are based on the amounts attributable to the 79-day ownership period (January 13, 2004 March 31, 2004) divided by 91 days.

Refining and Supply earned $100 million in the first three months of 2004 versus $93 million in the first quarter of 2003. The $7 million improvement in results was largely due to the $23 million income contribution from the Eagle Point refinery acquired on January 13, 2004 (see below), higher production volumes in the Northeast Refining System ($8 million) and slightly higher realized margins ($12 million). Partially offsetting these positive variances were higher expenses ($23 million), including fuel and depreciation, lower production volumes in Sunoco s MidContinent Refining System ($8 million) due to planned turnaround activity at both the Toledo and Tulsa refineries in March 2004 and a higher effective income tax rate ($7 million).

Effective January 13, 2004, Sunoco completed the purchase of the 150 thousand barrels-per-day Eagle Point refinery and related assets from El Paso Corporation for $235 million, including inventory. In connection with this transaction, Sunoco assumed certain environmental and other liabilities. The Eagle Point refinery is located in Westville, NJ near the Company s existing Northeast refining operations. Management believes the acquisition of the Eagle Point refinery complements and enhances the Company s refining operations in the Northeast and enables the capture of significant synergies in the larger Northeast Refining Complex. The related assets acquired include certain pipeline and other logistics assets associated with the refinery which Sunoco sold to Sunoco Logistics Partners L.P. in March 2004. (See Notes 5 and 12 to the condensed consolidated financial statements.)

In the first quarter of 2004, El Paso informed Sunoco that it disagrees with Sunoco s computation of the total amount due for inventory purchased in connection with the Eagle Point refinery acquisition. Sunoco believes its estimated payment for inventory on the acquisition date included a $5 million overpayment, while El Paso believes that Sunoco should pay El Paso an additional $26 million. Sunoco believes its interpretation of the contractual obligation is correct and is attempting to resolve this dispute. Changes in the payment for inventory would be treated as an adjustment to the purchase price for the acquisition.

Retail Marketing

	For the Three Months Ended March 31	
	2004	**2003**
Income (loss) (millions of dollars)	$ (4)	$ 10
Retail margin* (per barrel):		
Gasoline	$ 2.68	$ 3.48
Middle distillates	$ 6.27	$ 5.98
Sales (thousands of barrels daily):		
Gasoline	273.7	251.2
Middle distillates	44.5	44.3
	318.2	295.5
Retail gasoline outlets	4,532	4,368

* Retail sales price less wholesale price and related terminalling and transportation costs divided by total sales volumes. The retail sales price is the weighted average price received through the various branded marketing distribution channels.

Retail Marketing had a loss of $4 million in the current three-month period versus income of $10 million in the first quarter of 2003. The $14 million decrease in results was due to lower retail gasoline margins ($14 million), which averaged 6.4 cents per gallon and were down almost two cents per gallon from the prior-year quarter. Current quarter results included a $1 million income contribution from the Speedway® sites acquired in June 2003 (see below).

In April 2004, Sunoco completed the purchase of 340 retail outlets currently operated under the Mobil® brand from ConocoPhillips for $181 million, including inventory. Of the total sites acquired, 112 are owned in fee or subject to long-term leases, with average throughput of approximately 175 thousand gallons per month. The remaining network consists of supply for 34 contract dealer-owned and operated locations and 194 branded locations. These outlets, which include 31 sites that are Company-operated and have convenience stores, are located primarily in Delaware, Maryland, Virginia and Washington, D.C. The Mobil® sites will be rebranded to Sunoco® gasoline and APlus® convenience stores over time. In the second quarter of 2003, Sunoco completed the purchase of 193 Speedway® retail gasoline sites from a subsidiary of Marathon

Ashland Petroleum LLC for $162 million, including inventory. The sites, which are located primarily in Florida and South Carolina, are all Company-operated locations with convenience stores. Of the 193 outlets, Sunoco became lessee for 54 of the sites under long-term lease agreements. The Speedway® sites are being re-branded as Sunoco® locations in the 2003-2004 period. The Company believes these acquisitions fit its long-term strategy to build a retail and convenience store network that will provide attractive long-term returns. In conjunction with Sunoco s retail portfolio management activities, in 2004, Sunoco intends to sell its ownership interest in approximately 50 of the Speedway® sites and convert them to distributor outlets that will market under the Sunoco® brand. During the first four months of 2004, 19 of these sites have been sold. (See Notes 5 and 12 to the condensed consolidated financial statements.)

*Chemicals**

	For the Three Months Ended March 31	
	2004	**2003**
Income (loss) (millions of dollars)	$ 12	$ (4)
Margin** (cents per pound):		
All products***	9.2	6.8
Phenol and related products	8.6	6.6
Polypropylene***	10.4	7.4
Sales (millions of pounds):		
Phenol and related products	614	670
Polypropylene	575	550
Plasticizers	28	157
Other	48	46
	1,265	1,423

* Prior-period amounts have been restated to reflect the consolidation of the Epsilon joint venture, effective January 1, 2003, in connection with the adoption of FASB Interpretation No. 46 in the first quarter of 2004.

** Wholesale sales revenue less cost of feedstocks, product purchases and related terminalling and transportation divided by sales volumes.

*** The 2004 polypropylene and all products margins include the impact of a long-term supply contract entered into on March 31, 2003 with Equistar Chemicals, L.P. which is priced on a cost-based formula that includes a fixed discount (see below).

Includes amounts attributable to the Bayport facility subsequent to its purchase, effective March 31, 2003.

Consists of amounts attributable to the plasticizer business, which was divested in January 2004.

Chemicals earned $12 million in the first quarter of 2004 versus a loss of $4 million in the prior-year period. The $16 million increase in earnings was due largely to higher realized margins ($16 million), primarily for phenol and related products and a $5 million income contribution associated with the 2003 propylene supply agreement with Equistar Chemicals, L.P. and sales from the Bayport, TX polypropylene facility acquired from Equistar. Phenol sales volumes declined 8 percent ($3 million) from the prior-year quarter as sales were limited by cumene availability issues in the industry. Polypropylene sales volumes (excluding the Bayport facility) declined 19 percent ($5 million) due to sales from inventory during the prior-year period.

During the fourth quarter of 2003, Sunoco announced its decision to sell its plasticizer business and in that period recorded a $23 million provision ($15 million after tax) to write down the assets held for sale to their estimated fair values less costs to sell and established a $5 million accrual ($2 million after tax) for employee terminations under a postemployment plan and for other required

exit costs. Sunoco sold this business and related inventory in January 2004 to BASF for approximately $90 million in cash. The sale included the Company s plasticizer facility in Pasadena, TX. The Company s Neville Island, PA, site was not part of the transaction and will continue to produce plasticizers exclusively for BASF under a three-year tolling agreement. Sunoco also agreed to provide terminalling services at this facility to BASF for a 15-year period. (See Note 5 to the condensed consolidated financial statements.)

Effective March 31, 2003, Sunoco formed a limited partnership with Equistar involving Equistar s ethylene facility in LaPorte, TX. Equistar is a joint venture between Lyondell Chemical Company and Millennium Chemicals Inc. In connection with this transaction, Equistar and the new partnership entered into a 700 million pounds-per-year, 15-year propylene supply contract with Sunoco. Of this amount, 500 million pounds per year is priced on a cost-based formula that includes a fixed discount that declines over the life of the contract, while the remaining 200 million pounds per year is based on market prices. Sunoco also purchased Equistar s polypropylene facility in Bayport, TX. Sunoco paid $194 million in cash and borrowed $4 million from the seller to form the partnership and acquire the Bayport facility. (See Note 5 to the condensed consolidated financial statements.)

Logistics

Sunoco s Logistics business, which is comprised of Sunoco s interest in Sunoco Logistics Partners L.P. as well as certain other assets and joint venture interests, earned $8 million in the first quarter of 2004 versus $11 million in the year-ago period. The $3 million decline in earnings was due largely to lower results from the Western Crude System and lower joint-venture income.

In March 2004, the Partnership purchased, for $20 million, certain pipeline and other logistics assets that had previously been acquired by Sunoco with the Eagle Point refinery and, in April 2004, acquired ConocoPhillips Baltimore, MD, and Manassas, VA, refined product terminals for $12 million. In addition, the Partnership intends to purchase an interest in the Harbor Pipeline from El Paso Corporation for $7 million (see Financial Capacity below).

Coke

Coke earned $9 million in the first quarter of 2004 versus $10 million in the first quarter of 2003.

In October 2003, Sun Coke entered into an agreement with three affiliates of International Steel Group (ISG) to build and operate a 550 thousand tons-per-year cokemaking facility in Haverhill, OH. Construction of this facility, which is estimated to cost approximately $140 million, commenced in December 2003, and the facility is expected to be operational in March 2005. In connection with this agreement, ISG has agreed to purchase 550,000 tons per year of coke from this facility, which is in addition to the 700,000 tons it currently is purchasing annually from the Company s Jewell production through 2005. These two contracts have been combined into a 15-year, 1.25 million tons-per-year contract. In addition, the heat recovery steam generation associated with the cokemaking process at this facility will provide low-cost steam to the Company s adjacent chemical manufacturing complex.

Sun Coke is currently discussing a venture with three major steel companies and a major iron ore producer under which Sun Coke would oversee the construction of a coke production facility and associated cogeneration power plant in Vitória, Brazil with an estimated cost of $350-$400 million. Sun Coke would operate the facilities and the other parties would take the coke production under long-term tolling agreements. One of the steel companies would purchase all of the

electricity produced at the facility. Subject to finalization of agreements among the parties, construction would begin in 2004, and the facilities would be operational in 2006. It is anticipated that ownership of the venture would be shared by several parties, including the off-takers, with Sun Coke owning a minority interest. Sun Coke s level of participation in this project is subject to approval of Sunoco s Board of Directors.

In addition, given the rise in demand for steel and the related demand increases for coke, the Company is currently discussing opportunities for new cokemaking facilities with many domestic and international steel companies. Any new ventures would generally have an ownership structure similar to the Company s proposed venture in Vitória, Brazil.

Corporate and Other

Corporate Expenses Corporate administrative expenses were $12 million after tax in the current quarter versus $9 million in the first quarter of 2003. The $3 million increase was largely due to higher employee-related expenses, including accruals associated with stock-based compensation.

Analysis of Condensed Consolidated Statements of Income

Revenues Total revenues were $5.25 billion in the first three months of 2004 compared to $4.60 billion in the first three months of 2003. The 14 percent increase was primarily due to significantly higher refined product sales volumes, largely attributable to the acquisition of the Eagle Point refinery and the Speedway retail sites. Also contributing to the increase were higher refined product prices, higher consumer excise taxes and higher convenience store merchandise sales volumes.

Costs and Expenses Total pretax costs and expenses were $5.10 billion in the first three months of 2004 compared to $4.46 billion in the first three months of 2003. The 14 percent increase was primarily due to significantly higher crude oil and refined product acquisition costs. The higher crude oil acquisition costs reflect the Company s higher crude oil throughputs resulting from the acquisition of the Eagle Point refinery, while the higher refined product acquisition costs reflect purchases to supply the Speedway® retail sites located primarily in Florida and South Carolina. Also contributing to the increase were higher consumer excise taxes, higher selling, general and administrative expenses and the cost of higher merchandise sales at the Company s convenience store outlets.

FINANCIAL CONDITION

Cash and Working Capital

At March 31, 2004, Sunoco had cash and cash equivalents of $311 million compared to $431 million at December 31, 2003, and had a working capital deficit of $90 million compared to a working capital deficit of $73 million at December 31, 2003. The $120 million decrease in cash and cash equivalents was due to a $249 million net use of cash in investing activities and a $59 million net use of cash in financing activities, partially offset by $188 million of net cash provided by operating activities (cash generation). Sunoco s working capital position is considerably stronger than indicated because of the relatively low historical costs assigned under the LIFO method of accounting for most of the inventories reflected in the condensed consolidated balance sheets. The current replacement cost of all such inventories exceeded their carrying value at March 31, 2004 by $1,214 million. Inventories valued at LIFO, which consist of crude oil, and petroleum and chemical products, are readily marketable at their current replacement values. Management believes that the current levels of cash and working capital are adequate to support

Sunoco s ongoing operations.

Cash Flows from Operating Activities

In the first three months of 2004, Sunoco s cash generation was $188 million compared to $378 million in the first three months of 2003. This $190 million decrease in cash generation was primarily due to the absence of a $73 million income tax refund received in March 2003 and a decrease in other working capital sources pertaining to operating activities largely as a result of an increase in refined product inventory, partially offset by higher depreciation, depletion and amortization.

Financial Capacity

Management currently believes that future cash generation will be sufficient to satisfy Sunoco s ongoing capital requirements, to fund its pension obligations (see Pension Plan Funded Status below) and to pay the current level of cash dividends on Sunoco s common stock. However, from time to time, the Company s short-term cash requirements may exceed its cash generation due to various factors including reductions in margins for products sold and increases in the levels of capital spending (including acquisitions) and working capital. During those periods, the Company may supplement its cash generation with proceeds from financing activities.

The Company has a revolving credit facility (the Facility) totaling $785 million, which consists of a $385 million commitment through July 2005 and a $400 million commitment that matures in July 2004. The Company intends to establish a replacement facility during the second quarter of 2004. The Facility provides the Company with access to short-term financing and is intended to support the issuance of commercial paper and letters of credit. The Company also can borrow directly from the participating banks under the Facility. The Facility is subject to commitment fees, which are not material. Under the terms of the Facility, Sunoco is required to maintain tangible net worth (as defined in the Facility) in an amount greater than or equal to targeted tangible net worth (targeted tangible net worth being determined by adding $1.0 billion and 50 percent of the excess of net income over share repurchases (as defined in the Facility) for each quarter ended after March 31, 2002). At March 31, 2004, the Company s tangible net worth was $1.6 billion and its targeted tangible net worth was $1.1 billion. The Facility also requires that Sunoco s ratio of consolidated net indebtedness, including borrowings of Sunoco Logistics Partners L.P., to consolidated capitalization (as those terms are defined in the Facility) not exceed .60 to 1. At March 31, 2004, this ratio was .43 to 1. At March 31, 2004, $100 million of commercial paper was outstanding related to the above short-term borrowing arrangements.

Sunoco Logistics Partners L.P. has a three-year $250 million revolving credit facility through January 2005, which is available to fund the Partnership s working capital requirements, to finance acquisitions, and for general partnership purposes. It includes a $20 million distribution sublimit that is available for distributions to third-party unitholders and Sunoco. At March 31, 2004, $65 million was outstanding under this credit facility, which is classified as current portion of long-term debt in the condensed consolidated balance sheet. The credit facility contains convenants requiring the Partnership to maintain a ratio of up to 4 to 1 of its consolidated total debt to its consolidated EBITDA (each as defined in the credit facility) and an interest coverage ratio (as defined in the credit facility) of at least 3.5 to 1. At March 31, 2004, the Partnership s ratio of its consolidated debt to its consolidated EBITDA was 2.8 to 1 and the interest coverage ratio was 5.4 to 1. The Partnership intends to establish a replacement facility in 2004.

The Company s Epsilon joint venture has a $40 million revolving credit facility that matures in September 2006. The credit facility contains restrictive covenants which, among other things, limit the incurrence of additional debt and the sale of assets by Epsilon. At March 31, 2004, $30 million was outstanding under this credit facility, which is guaranteed by Sunoco, Inc.

The following table sets forth Sunoco s outstanding borrowings (in millions of dollars):

	At March 31 2004	At December 31 2003
Short-term borrowings	$ 100	$
Current portion of long-term debt	67	103
Long-term debt	1,434	1,498
Total borrowings	$ 1,601	$ 1,601

In the first quarter of 2004, the Company issued $100 million of commercial paper and used the proceeds to repay its $100 million of 7 1/8 percent notes that were due in March 2004. Management believes there is sufficient borrowing capacity available to pursue strategic investment opportunities as they arise. In addition, the Company has the option of issuing additional common or preference stock or selling a portion of its Sunoco Logistics Partners L.P. common units (see below).

The Company has an effective shelf registration statement which provides the Company with financing flexibility to offer senior and subordinated debt, common and preferred stock, warrants and trust preferred securities. At March 31, 2004, $1,300 million remains available under this shelf registration statement. Sunoco Logistics Partners L.P. also has an effective shelf registration statement, under which the Partnership may sell debt or common units representing limited partner interests. The amount, type and timing of any financings under these registration statements will depend upon, among other things, the Company s and the Partnership s funding requirements, market conditions and compliance with covenants contained in the Company s and the Partnership s respective debt obligations and revolving credit facilities. Subsequent to the Partnership s April 2004 equity offering (see below), $365 million remains available under the Partnership s shelf registration statement.

In April 2004, the Partnership issued 3.4 million limited partnership units under its effective shelf registration statement at a price of $39.75 per unit. Proceeds from the offering totaled approximately $129 million net of underwriting discounts and offering expenses. Coincident with the offering, the Partnership redeemed for $83 million, 2.2 million limited partnership units owned by Sunoco. Upon completion of the offering and related redemption of Sunoco s limited partnership units, Sunoco now has a 62.6 percent interest in the Partnership, including its 2 percent general partnership interest. The accounts of the Partnership continue to be included in Sunoco s consolidated financial statements. No gain or loss was recognized on these transactions. The proceeds from the offering were also used by the Partnership to finance the $20 million acquisition in March 2004 of certain pipeline and other logistics assets previously purchased by Sunoco with the Eagle Point refinery and the $12 million purchase in April 2004 of two ConocoPhillips refined product terminals located in Baltimore, MD and Manassas, VA. The logistics assets sold to the Partnership by Sunoco consist of crude oil and refined product ship and barge docks; refined product truck racks; and a 4.5 mile refined product pipeline from the Eagle Point refinery to the origin of the Harbor Pipeline. In addition, the Partnership intends to use proceeds from the offering to purchase an interest in the Harbor Pipeline from El Paso Corporation for $7 million.

Off-Balance Sheet Arrangement

In December 2003, a wholly owned subsidiary of the Company, Sunoco Receivables Corporation, Inc., entered into a three-year accounts receivable securitization facility under which the subsidiary may sell on a revolving basis up to a $200 million

undivided interest in a designated pool of certain accounts receivable. This facility replaced a $200 million facility that was scheduled to terminate in 2004. No receivables have been sold to third parties under either of these facilities.

PENSION PLAN FUNDED STATUS

The following table sets forth the components of the change in market value of the investments in Sunoco s defined benefit pension plans for the first three months of 2004 and the full-year 2003 (in millions of dollars):

	Three Months Ended March 31, 2004	Year Ended December 31, 2003
Market value of investments at beginning of period	$ 1,071	$ 930
Increase (reduction) in market value of investments resulting from:		
Net investment income	37	211
Company contributions	18	89
Plan benefit payments	(30)	(159)
	$ 1,096	$ 1,071

Pension expense for 2004 is projected to increase approximately $10 million after tax. Although the Company is not required to make any contributions to its funded benefit plans in 2004, it currently plans to contribute an estimated $50 million to these plans during the year. In March 2002, a temporary interest-rate-relief bill was enacted by Congress that mitigated the impact of a decline in interest rates used in pension funding calculations. In April 2004, Congress enacted additional legislation that continues the use of more favorable interest rates for determining funding requirements for 2004 and 2005. The new bill replaces the interest rate on 30-year Treasury bonds with a rate based on corporate bonds.

Management believes any additional contributions to the pension plans can be funded without a significant impact on liquidity. Future changes in the equity markets and/or the discount rate could result in additional significant increases or decreases to the accumulated other comprehensive loss component of shareholders equity and to future pension expense and funding requirements.

SHARE REPURCHASES

During the first three months of 2004, the Company repurchased 600,000 shares of common stock for $37 million. At March 31, 2004, the Company had a remaining authorization from its Board of Directors to purchase up to $230 million of Company common stock in the open market from time to time depending on prevailing market conditions and available cash (see Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities below).

FORWARD-LOOKING STATEMENTS

Statements and financial discussion and analysis contained in the foregoing report that are not historical facts are forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These statements discuss goals, intentions and expectations as to future trends, plans, events, results of operations or financial condition, or state other information relating to the Company, based on current beliefs of management as well as assumptions made by, and information currently available to, Sunoco. Forward-looking statements generally will be accompanied by words such as anticipate, believe, could, estimate, expect, forecast, intend, possible, potential, predict, project, or other similar words, phrases or expressions that convey the uncertainty of future events or outcomes.

Although Sunoco believes these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. Forward-looking statements involve a number of risks and uncertainties. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

Changes in refining, marketing and chemical margins;

Variation in petroleum-based commodity prices and availability of crude oil and feedstock supply or transportation;

Volatility in the marketplace which may affect supply and demand for Sunoco s products;

Changes in competition and competitive practices, including the impact of foreign imports;

Changes in the reliability and efficiency of the Company s operating facilities or those of third parties;

Changes in the level of operating expenses and hazards common to operating facilities (including equipment malfunction, explosions, fires, oil spills, and the effects of severe weather conditions);

Changes in the expected level of environmental capital, operating or remediation expenditures;

Delays related to construction of or work on facilities and the issuance of applicable permits;

Changes in product specifications;

Availability and pricing of oxygenates such as MTBE and ethanol;

Phase-outs or restrictions on the use of MTBE;

Political and economic conditions in the markets in which the Company operates, including the impact of potential terrorist acts and international hostilities;

Military conflicts between, or internal instability in, one or more oil producing countries, governmental actions and other disruptions in the ability to obtain crude oil;

Changes in the availability and cost of debt and equity financing;

Changes in insurance markets impacting costs and the level and types of coverage available;

Changes in financial markets impacting pension expense and funding requirements;

Risks related to labor relations;

Nonperformance by major customers, suppliers or other business partners;

General economic, financial and business conditions which could affect Sunoco s financial condition and results of operations;

Changes in applicable statutes and government regulations or their interpretations, including those relating to the environment and global warming;

Claims of the Company s noncompliance with statutory and regulatory requirements; and

Changes in the status of, or initiation of new, litigation to which the Company is a party or liability resulting from litigation or administrative proceedings, including natural resource damage claims.

The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by Sunoco. Unpredictable or unknown factors not discussed herein could also have material adverse effects on the Company. All forward-looking statements included in this Form 10-Q are expressly qualified in their entirety by the foregoing cautionary statements. The Company undertakes no obligation to update publicly any forward-looking statement (or its associated cautionary language) whether as a result of new information or future events.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes to the Company s exposure to market risk since December 31, 2003.

Item 4. Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, as of the end of the period covered by this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company s management, including the Company s Chairman, Chief Executive Officer and President and the Company s Senior Vice President and Chief Financial Officer. Based upon that evaluation, the Company s Chairman, Chief Executive Officer and President and the Company s Senior Vice President and Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective. There have been no changes in the Company s internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

Disclosure controls and procedures are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company s Chairman, Chief Executive Officer and President and the Company s Senior Vice President and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

Various lawsuits and governmental proceedings arising in the ordinary course of business are pending against the Company, as well as the lawsuits and proceedings discussed below.

Administrative Proceedings

In 1994, pursuant to amendments to the Clean Air Act, Pennsylvania promulgated reasonably available control technology (RACT) regulations to control emissions of nitrogen oxide (NOx) and volatile organic compounds (VOC) from regulated facilities. In the same year, Sunoco, Inc. (R&M), a subsidiary of Sunoco, Inc., submitted a proposal designating its preferred RACT for each affected source in its Marcus Hook refinery. Two boilers were subject to the regulations. In June 1995, the Pennsylvania Department of Environmental Protection (PaDEP) issued a RACT Plan Approval and Compliance Permit for both boilers with a compliance deadline of 1996. While Sunoco, Inc. (R&M) disagreed with PaDEP s RACT determination and engaged in an ongoing dialogue with the agency as to the best way to comply, the Company did not file an administrative appeal of the Plan Approval and Compliance Permit. Thereafter, in 1997, PaDEP issued a Notice of Violation to Sunoco, Inc. (R&M) alleging failure to comply with the 1995 Plan Approval and Compliance Permit. In 1998, PaDEP issued an Abatement Order to Sunoco, Inc. (R&M) to comply with the 1995 Plan Approval and Compliance Permit. After lengthy negotiations with PaDEP, Sunoco, Inc. (R&M) and PaDEP agreed on the appropriate RACT equipment for both boilers and the designated control equipment was installed. PaDEP imposed a civil penalty in the amount of $3.5 million on Sunoco, Inc. (R&M) for failure to timely comply with the 1995 Plan Approval and Compliance Permit. (Please refer to the Company s Quarterly Reports on Form 10-Q for the quarterly periods ended June 30, 2000 and June 30, 2002.) Sunoco, Inc. (R&M) appealed the civil penalty to the Pennsylvania Environmental Hearing Board, and in April 2004, the Hearing Board dismissed the appeal. The Company filed a motion for reconsideration with the Hearing Board, which was denied. The Company is preparing to file an appeal before the Commonwealth Court of Pennsylvania.

In April 2001, Sunoco, Inc. (R&M) received a civil penalty demand in excess of $100,000 from the Ohio Attorney General s office, representing the Ohio Environmental Protection Agency (Ohio EPA), for alleged exceedences of permit emission limitations relating to the sulfur recovery unit and the flare at the Sunoco Inc. (R&M) Toledo, OH refinery. (Please refer to the Company s Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2001.) In March 2004, Sunoco, Inc. (R&M) and the Ohio EPA signed a Consent Order and Final Judgment Entry pursuant to which Sunoco, Inc. (R&M) will pay a penalty in the amount of $475,000. Sunoco, Inc. (R&M) also agreed to continue to use operating and study requirements in a 1995 Consent Decree.

In January 2004, Sunoco, Inc. and one of its independent dealers received an administrative order and notice of civil administration penalty assessment in excess of $100,000 from the New Jersey Department of Environmental Protection (NJDEP) alleging failure to remediate discharges at the site and failure to submit and implement a remedial action work plan addendum for a service station location in Towaco, NJ. (Please refer to the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2003.) The location was formerly owned by Sunoco and sold to the dealer. Sunoco has requested a hearing on this matter.

MTBE Litigation

Sunoco is a defendant in cases in over 60 lawsuits pending in 17 states which involve the manufacture and use of MTBE in gasoline and MTBE contamination in groundwater. The lawsuits are substantially identical and the plaintiffs are generally water providers, governmental authorities and private well owners alleging that refiners and suppliers of gasoline containing MTBE are responsible for manufacturing and distributing a defective product. Many other refiners and suppliers of gasoline are defendants in some or all of these cases. Most of the cases filed in state courts have been removed to federal court by motion of the defendants and consolidated for pre-trial purposes in the U.S. District Court, Southern District of New York by the Judicial Panel on Multidistrict Litigation. Motions to remand the cases to their respective state courts are pending before the judge. The cases include the following:

Port Washington, NY, et al. v. Sunoco, et al. (U.S.D.C., Eastern District of NY) was served in March 2004. Sunoco is one of several defendants which include manufacturers, refiners, formulators, distributors, suppliers, sellers and/or marketers of MTBE and/or gasoline containing MTBE. This case alleges product liability/defective product, public and private nuisance, failure to warn, negligence, trespass, civil conspiracy, and violation of the New York State Navigation Law, and violation of the Deceptive Business Acts and Practices. Plaintiffs seek injunctive relief, compensatory and punitive damages, and interest and costs.

Incorporated Village of Sands Point v. Sunoco, et al. (Supreme Court of the State of New York), was served in January 2004. Sunoco is one of several defendants which include manufacturers, refiners, formulators, distributors, suppliers, sellers and/or marketers of MTBE and/or gasoline containing MTBE. The case alleges product liability/defective product, nuisance, failure to warn, negligence, deceptive business acts and practices, and violation of the New York State Navigation Law. Plaintiffs seek compensatory and punitive damages.

Up to this point, for the group of MTBE cases currently pending, there has been little information developed about the plaintiffs legal theories or the facts that would be relevant to an analysis of potential exposure. Based on the current law and facts available at this time, Sunoco believes that these cases will not have a material adverse effect on its consolidated financial position.

Many other legal and administrative proceedings are pending or possible against Sunoco from its current and past operations, including proceedings related to commercial and tax disputes, product liability, antitrust, employment claims, leaks from pipelines and underground storage tanks, natural resource damage claims, premises-liability claims, allegations of exposures of third parties to toxic substances (such as benzene or asbestos) and general environmental claims. Although the ultimate outcome of these proceedings cannot be ascertained at this time, it is reasonably possible that some of them could be resolved unfavorably to Sunoco. Management of Sunoco believes that any liabilities that may arise from such proceedings would not be material in relation to Sunoco s business or consolidated financial position at March 31, 2004.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

The following table provides a summary of all repurchases by the Company of its common stock during the three-month period ended March 31, 2004:

Period	Total Number Of Shares Purchased (In Thousands)	Average Price Paid (Per Share)	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (In Thousands)	Appropriate Dollar Value That May Yet Be Purchased Under the Plans or Programs at Period End (In Millions)
January 2004	75	$ 55.57		$ 249
February 2004	100	$ 59.59	100	$ 251
March 2004	500	$ 61.24	500	$ 230
	675	$ 60.37	600	

In July 2001, the Company s Board of Directors approved a $500 million share repurchase program with no stated expiration date. All of the shares repurchased during the three-month period ended March 31, 2004 were acquired pursuant to this program, except that the 75 thousand shares acquired in January were purchased from employees. These shares were acquired in connection with stock swap transactions related to the exercise of stock options and with the settlement of tax withholding obligations arising from payment of common stock unit awards.

Item 6. Exhibits and Reports on Form 8-K

Exhibits:

10.1	Form of Amended and Restated Indemnification Agreement dated as of March 4, 2004, individually entered into between Sunoco, Inc. and various directors, officers and other key employees of the Company.
10.2	Schedule to the Form of Amended and Restated Indemnification Agreement, individually entered into between Sunoco, Inc. and various directors, officers and other key employees of the Company.
12	Statements re Sunoco, Inc. and Subsidiaries Computation of Ratio of Earnings to Fixed Charges for the Three-Month Periods Ended March 31, 2004 and 2003.
31.1	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1	Certification of Periodic Financial Report Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
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Reports on Form 8-K:

On January 14, 2004, the Company furnished under Item 7 Financial Statements, Pro Forma Financial Information and Exhibits and Item 9 Regulation FD Disclosure of Form 8-K a copy of its press release issued January 13, 2004, which included an announcement that it had closed its previously announced acquisition of the Eagle Point refinery in Westville, NJ from El Paso Corporation. The Company also furnished under these Items additional information concerning this acquisition that was presented to investors in a teleconference call on January 14, 2004. In this Form 8-K, the Company also furnished under Item 7 and Item 12 Results of Operations and Financial Condition a copy of its press release issued January 13, 2004, which included an announcement of certain projected financial results for its 2003 fourth quarter.

On January 22, 2004, the Company furnished under Item 7 Financial Statements, Pro Forma Financial Information and Exhibits and Item 12 Results of Operations and Financial Condition of Form 8-K, a copy of its earnings press release for the fourth quarter of 2003 that was issued on January 22, 2004. In this Form 8-K, the Company also furnished under Item 7 and Item 9 Regulation FD Disclosure additional information concerning the Company s fourth quarter earnings that was presented to investors in a teleconference call on January 22, 2004.

On January 28, 2004, the Company filed a Form 8-K to provide under Item 2 Acquisition or Disposition of Assets a brief description of the acquisition of the Eagle Point refinery, which was completed effective January 13, 2004. That Form 8-K also reported under Item 7 Financial Statements, Pro Forma Financial Information and Exhibits that financial statements related to this acquisition would be filed by amendment on or before March 29, 2004. On March 26, 2004, the Company filed a Form 8-K/A under which it disclosed that the acquisition was not deemed significant under the rules and regulations of the Securities and Exchange Commission and, accordingly, the financial statements were not required and would not be filed pursuant to Item 7 of Form 8-K.

On February 6, 2004, the Company furnished under Item 7 Financial Statements, Pro Forma Financial Information and Exhibits and Item 9 Regulation FD Disclosure of Form 8-K information that was presented to certain investors by Sunoco executives at the Credit Suisse First Boston 2004 Energy Summit held on February 6, 2004.

On April 22, 2004, the Company furnished under Item 7 Financial Statements, Pro Forma Financial Information and Exhibits and Item 12 Results of Operations and Financial Condition of Form 8-K, a copy of its earnings press release for the first quarter of 2004 that was issued on April 22, 2004. In this Form 8-K, the Company also furnished under Item 7 and Item 9 Regulation FD Disclosure additional information concerning the Company s first quarter earnings that was presented to investors in a teleconference call on April 22, 2004.

****

We are pleased to furnish this Form 10-Q to shareholders who request it by writing to:

Sunoco, Inc.

Investor Relations

Ten Penn Center

1801 Market Street

Philadelphia, PA 19103-1699

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SUNOCO, INC.

BY /s/ JOSEPH P. KROTT

Joseph P. Krott
Comptroller
(Principal Accounting Officer)

DATE May 6, 2004

EXHIBIT INDEX

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="0" CELLSPACING="0" WIDTH="100%">**ITEM 2.MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U. S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expense, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to product returns, doubtful accounts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring costs, contingencies, and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the amount and timing of revenue and expense and the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

There have been no material changes to our significant accounting polices during the nine months ended October 1, 2010 from those disclosed in our 2009 Form 10-K, with the exception of our accounting policy for revenue recognition as described in Note 2 of the Notes to the Condensed Consolidated Financial Statements.

Recent Accounting Pronouncements

Updates to recent accounting standards as disclosed in our Annual Report on Form 10-K for the fiscal year ended January 1, 2010 are as follows:

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. This guidance, which is now codified under the Fair Value Measurements and Disclosures Topic of the FASB Accounting Standards Codification, requires new disclosures on the transfers of assets and liabilities between Level I (quoted prices in active market for identical assets or liabilities) and Level II (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuances, and settlements of the assets and liabilities measured using significant unobservable inputs (Level III fair value measurements). The guidance became effective for us with the reporting period beginning January 2, 2010, except for the disclosure on the roll forward activities for Level III fair value measurements, which will become effective for us at the beginning of fiscal 2011. Other than requiring additional disclosures, adoption of this new guidance did not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued accounting guidance which changes the consolidation guidance applicable to a variable interest entity (VIE). The guidance, now codified under the Consolidation Topic of the FASB Accounting Standards Codification, also amends the guidance governing the determination of whether an enterprise is the primary beneficiary of a VIE, and is, therefore, required to consolidate an entity, by requiring a qualitative analysis rather than a quantitative analysis. The qualitative analysis will include, among other things, consideration of who has the power to direct the activities of the entity that most significantly impact the entity s economic performance and who has the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. This guidance also requires continuous reassessments of whether an enterprise is the primary beneficiary of a VIE. Previously, GAAP required reconsideration of whether an enterprise was the primary beneficiary of a VIE only when specific events had occurred. The Company adopted this guidance in the first quarter of fiscal 2010. The adoption of the guidance did not have a material impact on our financial position, results of operations or cash flows.

In October 2009, the FASB issued an amendment which eliminates the residual method of allocation for multiple-deliverable revenue arrangements and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. In addition, the guidance updated whether multiple deliverables exist and how the deliverables in an arrangement should be separated. The amendment also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor specific objective evidence (VSOE) if available; (2) third-party evidence (TPE) if VSOE evidence is not available; and (3) estimated selling (ESP) price if neither VSOE nor TPE is available. In addition, the FASB modified the accounting for revenue arrangements that include both tangible products and software elements, such that tangible products containing both software and non-software components that function together to deliver the tangible product s essential functionality are no longer within the scope of software revenue guidance. Both amendments are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. We early adopted this guidance in the first quarter of fiscal 2010 on a prospective basis. See Note 2 of the Notes to the Condensed Consolidated Financial Statements for a more detailed discussion.

EXECUTIVE LEVEL OVERVIEW

Trimble s focus is on combining positioning technology with wireless communication and application capabilities to create system-level solutions that enhance productivity and accuracy for our customers. The majority of our markets are end-user markets, including engineering and construction firms, governmental organizations, public safety workers, farmers, and companies who must manage fleets of mobile workers and assets. In our Advanced Devices segment, we also provide components to original equipment manufacturers to incorporate into their products. In the end-user markets, we provide a system that includes a hardware platform that may contain software and customer support. Some examples of our solutions include products that automate and simplify the process of surveying land, products that automate the utilization of equipment such as tractors and bulldozers, products that enable a company to manage its mobile workforce and assets, and products that allow municipalities to manage their fixed assets. In addition, we also provide software applications on a stand-alone basis. For example, we provide software for project management on construction sites.

Solutions targeted at the end-user make up a significant majority of our revenue. To create compelling products, we must attain an understanding of the end-users needs and work flow, and how location-based technology can enable that end-user to work faster, more efficiently, and more accurately. We use this knowledge to create highly innovative products that change the way work is done by the end-user. With the exception of our Mobile Solutions and Advanced Devices segments, our products are generally sold through a dealer channel, and it is crucial that we maintain a proficient, global, third-party distribution channel.

We continued to execute our strategy with a series of actions that can be summarized in three categories.

Reinforcing our position in existing markets

* We believe these markets provide us with additional, substantial potential for substituting our technology for traditional methods. We are continuing to develop new products and to strengthen our distribution channels in order to expand our market.

In our Engineering and Construction segment, we expanded our network of SITECH Technology Dealers by adding SITECH dealerships in geographic locations such as Florida, Georgia, Alabama, Brazil, Australia, Mexico and Central Russia. These dealers represent Trimble and Caterpillar machine control systems for the contractor s entire fleet of heavy equipment, regardless of machine brand. We also introduced new Trimble 4D Control software solutions for monitoring systems, which include support for geotechnical sensors and a user-friendly Web Module. We also rolled out the Trimble MX8 Mobile Spatial Imaging System, which is an advanced mobile data capture system that combines imaging and laser scanning capabilities to measure objects in 3D to produce 3D, 4D and 5D data sets for spatial imaging projects.

In our Field Solutions segment, we introduced the CFX-750 display, which features the latest in-cab touch screen, full-color display that allows farmers to choose the specific guidance, steering and precision agriculture capabilities that best fit their farm s particular needs. We also rolled out new and enhanced variable rate and boom control options to the Field-IQ crop input control system which help farmers manage pest and nutrient applications by avoiding spray overlap. We enhanced the Juno SD Handheld to provide complete and compact solutions for Field Workforce Asset Management with voice and data capability. We introduced the Trimble Trident Analyst 2010 for spatial imaging, roadway signs, and GIS. This new software provides advanced information extraction capabilities, which provide users with increased capability and productivity.

In our Mobile Solutions segment, we launched a global safety initiative to help fleets become safer, more efficient and greener, including the introduction of the Trimble DriverSafety solution. This solution is designed to provide real-time feedback of unsafe maneuvers to drivers and a comprehensive picture for safety managers and fleet operation teams to accurately measure and mitigate fleet safety risks.

In our Advanced Devices segment, we introduced the Trimble AP10 receiver, which was the latest addition to the Trimble AP line of embedded GNSS-Inertial OEM board products that combine high-performance precision Global Navigation Satellite System (GNSS) and Applanix IN-Fusion GNSS-Inertial integration technology, running on a powerful, dedicated Inertial Engine (IE) board. The AP Series is ideal for a variety of commercial mobile positioning applications, including airborne, terrestrial and marine mapping and guidance for unmanned vehicles.

Extending our position in new and existing markets through new product categories

* We announced the formation of joint venture with Hilti, which will integrate Trimble s positioning and asset management technologies with Hilti s tools capabilities to create smarter tools and a smarter construction site. With the acquisition of Accubid, we established project management capabilities in the electrical BIM software space.

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Bringing existing technology to new markets

* We continue to reinforce our position in existing markets and position ourselves in newer markets that will serve as important sources of future growth. Our efforts are focused in emerging markets in Africa, China, India, the Middle-East and Russia. SITECH Central Russia has been established offering a comprehensive portfolio of construction technology systems to heavy and highway contractors in Central Russia.

RECENT BUSINESS DEVELOPMENTS

The following companies and joint ventures were acquired or formed during twelve months ended October 1, 2010 and are combined in our results of operations since the date of acquisition or formation:

Intelligent Construction Tools, LLC.

On September 29, 2010, we and the Hilti Group formed a joint venture, Intelligent Construction Tools, LLC. The joint venture, 50 percent owned by us and 50 percent owned by Hilti, will focus on leveraging technologies from both companies to develop measuring solutions for the building construction trades.

Cengea

On September 10, 2010, we acquired privately-held Cengea Solutions Inc., based in British Columbia. Cengea is a leading provider of spatially-enabled business operations and supply chain management software for the forestry, agriculture and natural resource industries. Cengea s performance is reported under our Mobile Solutions business segment.

Accubid Systems

On August 12, 2010, we acquired the assets of privately-held Accubid Systems, based in Concord, Ontario, Canada. Accubid is a leading provider of estimating, project management and service management software and services for electrical and mechanical contractors. Accubid s performance is reported under our Engineering and Construction business segment.

Punch Telematix NV

On July 7, 2010, we acquired control of Punch Telematix NV. Punch was a public company based in Belgium and engaged in the development and marketing of transport management solutions. Punch s performance is reported under our Mobile Solutions business segment.

Zhongtie Trimble Digital Engineering and Construction Limited Company

On June 28, 2010, we and the China Railway Eryuan Engineering Group Co. Ltd. (CREEC) formed a joint venture, Zhongtie Trimble Digital Engineering and Construction Limited Company (ZTD). We and CREEC both maintain a 50 percent ownership of ZTD. ZTD will leverage Trimble s commercial positioning, communications and software technologies, as well as CREEC s expertise in rail design and construction, to develop and provide digital railway solutions that address the design, construction and maintenance for the Chinese railway industry.

Definiens

On June 10, 2010, we acquired Definiens Earth Sciences business assets and licenses of its software technology platform. Definiens is a Germany-based company specializing in image analysis solutions. Definiens performance is reported under our Engineering and Construction business segment.

Rusnavgeoset Limited Liability Company

On May 14, 2010, we and Russian Space Systems formed a joint venture, Rusnavgeoset Limited Liability Company (Rusnavgeoset). We and Russian Space Systems both maintain a 50 percent ownership of Rusnavgeoset. Rusnavgeoset will be responsible for selling commercial Global Navigation Satellite System (GNSS) geodetic network infrastructure systems localized for Russia and the Commonwealth of Independent States.

LET Systems

On March 4, 2010, we acquired privately-held LET Systems based in Cork, Ireland. LET Systems is an internationally recognized leader in incident and outage management system solutions for utilities. LET Systems performance is reported under our Field Solutions business segment.

Pondera Engineers

On January 27, 2010, we acquired the assets of privately-held Pondera Engineers LLC based in Post Falls, Idaho. Pondera is an engineering and development company offering services and software tools for siting, designing, optimizing, and maintaining high-voltage power transmission and distribution lines. Pondera s performance is reported under our Field Solutions business segment.

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Seasonality of Business

* Our individual segment revenue may be affected by seasonal buying patterns. Typically, the second fiscal quarter has been the strongest quarter for the Company driven by the construction buying season. However during the recent past, this pattern has been disrupted by the global economic downturn.

RESULTS OF OPERATIONS

Overview

The following table is a summary of revenue, gross margin, and operating income for the periods indicated and should be read in conjunction with the narrative descriptions below.

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**	**October 1, 2010**	**October 2, 2009**
Total consolidated revenue	$ 318,210	$ 269,713	$ 970,588	$ 848,730
Gross margin	$ 159,748	$ 132,458	$ 482,171	$ 419,216
Gross margin %	50.2%	49.1%	49.7%	49.4%
Total consolidated operating income	$ 31,670	$ 20,165	$ 108,346	$ 73,143
Operating income %	10.0%	7.5%	11.2%	8.6%

Revenue

In the three months ended October 1, 2010, total revenue increased by $48.5 million or 18%, as compared to the same corresponding period in fiscal 2009. Of the increase, Engineering and Construction revenue increased $40.2 million, Field Solutions increased $11.6 million, slightly offset by a decrease in Mobile Solutions of $1.9 million and a decrease in Advanced Devices of $1.4 million. The revenue increase was primarily due to a return to growth in the U.S. and rest of the world markets in Engineering and Construction and higher sales in Field Solutions due to increased farmer demand for agricultural products.

In the nine months ended October 1, 2010, total revenue increased by $121.9 million or 14%, as compared to the same corresponding period in fiscal 2009. Of the increase, Engineering and Construction revenue increased $111.4 million, Field Solutions increased $8.7 million, and Advanced Devices increased $4.9 million, slightly offset by a decrease in Mobile Solutions of $3.1 million. The revenue increase was primarily due to the economic recovery in the U.S. and rest of the world markets in Engineering and Construction.

Gross Margin

Gross margin varies due to a number of factors including product mix, pricing, distribution channel, production volumes, and foreign currency translations.

Gross margin increased by $27.3 million and $63.0 million for the three and nine months ended October 1, 2010, respectively, as compared to the corresponding periods in the prior year, primarily due to increased sales in Engineering and Construction. Gross margin as a percentage of total revenue for the three months ended October 1, 2010 was 50.2%, as compared to 49.1% for the three months ended October 2, 2009. Gross margin as a percentage of total revenue for the nine months ended October 1, 2010 was 49.7%, as compared to 49.4% for the nine months ended October 2, 2009. The increase in gross margin percentage for the three and nine month periods ended October 1, 2010 was primarily due to product mix.

Operating Income

Operating income increased by $11.5 million and $35.2 million for the three and nine months ended October 1, 2010, respectively, as compared to the corresponding periods in the prior year, primarily due to higher revenue. Operating income as a percentage of total revenue was 10.0% for the three months ended October 1, 2010, as compared to 7.5% for the three months ended October 2, 2009. Operating income as a percentage of total revenue was 11.2% for the nine months ended October 1, 2010, as compared to 8.6% for the nine months ended October 2, 2009. The increase in operating income percentage for both the three and nine month periods was primarily due to higher revenue and increased operating leverage.

Results by Segment

To achieve distribution, marketing, production, and technology advantages in our targeted markets, we manage our operations in the following

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four segments: Engineering and Construction, Field Solutions, Mobile Solutions, and Advanced Devices. Operating income equals net revenue less cost of sales and operating expense, excluding general corporate expense, amortization of purchased intangibles, amortization of inventory step-up, non-recurring acquisition costs, and restructuring charges.

The following table is a summary of revenue and operating income by segment:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	October 1, 2010	October 2, 2009	October 1, 2010	October 2, 2009
Engineering and Construction				
Revenue	$ 189,598	$ 149,384	$ 535,657	$ 424,275
Segment revenue as a percent of total revenue	60%	55%	55%	49%
Operating income	$ 36,589	$ 21,131	$ 89,317	$ 42,800
Operating income as a percent of segment revenue	19%	14%	17%	10%
Field Solutions				
Revenue	$ 67,240	$ 55,654	$ 243,299	$ 234,598
Segment revenue as a percent of total revenue	21%	21%	25%	28%
Operating income	$ 21,027	$ 16,286	$ 89,320	$ 88,637
Operating income as a percent of segment revenue	31%	29%	37%	38%
Mobile Solutions				
Revenue	$ 37,692	$ 39,572	$ 113,839	$ 116,925
Segment revenue as a percent of total revenue	12%	15%	12%	14%
Operating income (loss)	($83)	$ 3,367	$ 2,140	$ 10,163
Operating income (loss) as a percent of segment revenue	(0.2)%	9%	2%	9%
Advanced Devices				
Revenue	$ 23,680	$ 25,103	$ 77,793	$ 72,932
Segment revenue as a percent of total revenue	7%	9%	8%	9%
Operating income	$ 4,073	$ 4,488	$ 14,879	$ 13,633
Operating income as a percent of segment revenue	17%	18%	19%	19%

Unallocated corporate expense includes general corporate expense, amortization of inventory step-up, and non-recurring acquisition costs. A reconciliation of our consolidated segment operating income to consolidated income before income taxes follows:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	October 1, 2010	October 2, 2009	October 1, 2010	October 2, 2009
Consolidated segment operating income	$ 61,606	$ 45,272	$ 195,656	$ 155,233
Unallocated corporate expense	(15,214)	(10,345)	(43,751)	(33,992)
Amortization of purchased intangible assets	(14,432)	(13,620)	(42,165)	(38,968)
Restructuring charges	(290)	(1,142)	(1,394)	(9,130)
Consolidated operating income	31,670	20,165	108,346	73,143
Non-operating income, net	6,659	1,396	10,480	1,795
Consolidated income before taxes	$ 38,329	$ 21,561	$ 118,826	$ 74,938

Engineering and Construction

Engineering and Construction revenue increased by $40.2 million or 27% and $111.4 million or 26% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009. Segment operating income increased $15.5 million or 73% and $46.5 million or 109% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009.

The revenue growth for both the three months and nine month periods was primarily driven by a return to growth in the U.S. and rest of the world markets. Segment operating income for both the three and nine month periods increased primarily due to higher revenue and increased operating leverage.

Field Solutions

Field Solutions revenue increased by $11.6 million or 21% and $8.7 million or 4% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009. Segment operating income increased by $4.7 million or 29% and $0.7 million or 1% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009.

The revenue growth for both the three month and nine month periods was primarily driven by new products and increased farmer demand for agricultural products. Operating income for the three and nine month periods increased primarily due to higher revenue in our agricultural business.

Mobile Solutions

Mobile Solutions revenue decreased by $1.9 million or 5% and $3.1 million or 3% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding period in fiscal 2009. Segment operating income decreased by $3.5 million or 102% and $8.0 million or 79% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009.

The revenue decline for the three month period was primarily due to the impact of lower subscription service revenue due to the loss of a large customer contract, partially offset by earlier recognition of hardware revenue in accordance with the new revenue accounting guidance adopted on January 2, 2010 and the impact of acquisition revenue. The revenue decline for the nine month period was primarily due to the impact of lower subscription service revenue due to the customer contract loss, partially offset by the earlier recognition of hardware revenue and the impact of acquisition revenue. The operating income decline for the three and nine month periods was primarily due to a reduction in higher margin subscription service revenue, slightly offset by an increase in lower margin hardware revenue.

Advanced Devices

Advanced Devices revenue decreased by $1.4 million or 6% and increased by $4.9 million or 7% for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009. Segment operating income decreased by $0.4 million or 9% and increased by $1.2 million or 9% for three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009.

The decrease in revenue for the three month period was primarily due to lower sales in our military advanced systems business. The revenue increase for the nine month period was driven by a return to growth in both our component and GNSS position and orientation systems. Operating income was slightly down for the three month periods due to lower revenue in our military advanced systems business. Operating income increased in the nine month period primarily due to the increase in revenue, partially offset by increased sales expense.

Research and Development, Sales and Marketing, and General and Administrative Expense

Research and development (R&D), sales and marketing (S&M), and general and administrative (G&A) expense are summarized in the following table:

	Three Months Ended		**Nine Months Ended**	
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**	**October 1, 2010**	**October 2, 2009**
Research and development	$ 36,897	$ 33,250	$ 109,339	$ 100,844
Percentage of revenue	12%	12%	11%	12%
Sales and marketing	53,228	47,022	153,518	141,120
Percentage of revenue	17%	17%	16%	16%
General and administrative	29,637	23,237	85,474	75,901
Percentage of revenue	9%	9%	9%	9%
Total	$ 119,762	$ 103,509	$ 348,331	$ 317,865
Percentage of revenue	38%	38%	36%	37%

Overall, R&D, S&M, and G&A expense increased by approximately $16.3 million and $30.5 million for the three and nine months ended October 1, 2010, respectively, as compared to the corresponding periods in fiscal 2009.

Research and development expense increased by $3.6 million and $8.5 million for the three and nine month periods ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009, primarily due to increased outside engineering service and prototype expense, increased compensation expense, the inclusion of expense from acquisitions not included in the prior year, and foreign currency exchange rates. All of our R&D costs have been expensed as incurred. Costs of software developed for external sale subsequent to reaching technical feasibility were not considered material and were expensed as incurred. Spending overall was at approximately 12% and 11% of revenue in the three and nine months ended October 1, 2010, as compared to 12% in the corresponding periods in fiscal 2009.

* We believe that the development and introduction of new products are critical to our future success and we expect to continue active development of new products.

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Sales and marketing expense increased by $6.2 million and $12.4 million for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009. The increase was primarily due to increased compensation expense, the inclusion of expense from acquisitions not applicable in the prior year, and travel and trade show expense. Spending overall was at approximately 17% and 16% of revenue in the three and nine months ended October 1, 2010, as compared to 17% and 16% in the same corresponding periods in fiscal 2009.

* Our future growth will depend in part on the timely development and continued viability of the markets in which we currently compete, as well as our ability to continue to identify and develop new markets for our products.

General and administrative expense increased by $6.4 million and $9.6 million for the three and nine months ended October 1, 2010, respectively, as compared to the same corresponding periods in fiscal 2009 primarily due to increased compensation expense and the inclusion of expense from acquisitions not applicable in the prior year. Spending overall was at approximately 9% of revenue in the three and nine months ended October 1, 2010, as compared to 9% in the same corresponding period in fiscal 2009.

Amortization of Purchased Intangible Assets

* Amortization of purchased intangible assets was $14.4 million in the third quarter of fiscal 2010, as compared to $13.6 million in the third quarter of fiscal 2009. Of the total $14.4 million in the third quarter of fiscal 2010, $8.1 million is presented as a separate line within Operating expense and $6.3 million is included within Cost of sales on our Condensed Consolidated Statements of Income. The increase was due primarily to business acquisitions and asset purchases not included in the corresponding period of fiscal 2009. As of October 1, 2010, future amortization of intangible assets is expected to be $14.7 million during the remaining one quarter of fiscal 2010, $55.3 million during 2011, $47.5 million during 2012, $42.2 million during 2013, $20.3 million during 2014, and $23.2 million thereafter.

Restructuring Charges

Restructuring expense for the three and nine months ended October 1, 2010 and October 2, 2009 was as follows:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**	**October1, 2010**	**October 2, 2009**
Severance and benefits	$ 290	$ 1,142	$ 1,394	$ 9,130

During the three and nine months ended October 1, 2010, restructuring expense of $0.3 million and $1.4 million, respectively, was related to decisions to streamline processes and reduce the cost structure of the Company, with approximately 90 positions eliminated year to date. During the three and nine months ended October 1, 2010, of the total restructuring expense, $0.2 million and $1.2 million, respectively, was shown as a separate line within Operating expense, and $0.1 million and $0.2 million, respectively, was included within Cost of sales on our Condensed Consolidated Statements of Income.

During the three and nine months ended October 2, 2009, restructuring expense of $1.1 million and $9.1 million, respectively, was related to decisions to streamline processes and reduce the cost structure of the Company, with approximately 300 positions eliminated. During the three and nine months ended October 2, 2009, of the total restructuring expense, $0.9 million and $5.8 million, respectively, was shown as a separate line within Operating expense, and $0.2 million and $3.3 million, respectively, was included within Cost of sales on our Condensed Consolidated Statements of Income.

Restructuring liability:

The following table summarizes the restructuring activity for the nine months ended October 1, 2010:

(Dollars in thousands)	
Balance as of January 1, 2010	$ 2,628
Charges	1,394
Payments	(2,625)
Adjustments	(69)
Balance as of October 1, 2010	$ 1,328

The $1.3 million restructuring accrual consists of severance and benefits. The $1.3 million restructuring accrual is included in Other current liabilities and is expected to be settled in the third quarter of fiscal 2011.

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Non-operating Income, Net

The components of non-operating income, net, were as follows:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**	**October 1, 2010**	**October 2, 2009**
Interest income	$ 221	$ 124	$ 864	$ 546
Interest expense	(576)	(450)	(1,385)	(1,408)
Foreign currency transaction gain (loss)	77	792	(1,046)	760
Income (loss) from equity method investments, net	3,404	(58)	9,025	421
Other income, net	3,533	988	3,022	1,476
Total non-operating income, net	$ 6,659	$ 1,396	$ 10,480	$ 1,795

Non-operating income, net increased $5.3 million and $8.7 million for the three and nine months of fiscal 2010, respectively, as compared to the corresponding periods in fiscal 2009. The increase in the three months and nine month periods was primarily due to higher income from joint ventures and changes in deferred compensation plan asset gains (losses) included in Other income, net, partially offset by a change in foreign currency gains (losses).

Income Tax Provision

The Company s effective income tax rate for the three and nine months ended October 1, 2010 was 14.3% and 43.0%, respectively, as compared to 26.5% and 27.0%, respectively, for the three and nine months ended October 2, 2009. The effective income tax rate for the three months ended October 1, 2010 was lower than the statutory federal income tax rate of 35%, primarily due to the geographical mix of the Company s per-tax income. The effective income tax rate for the nine months ended October 1, 2010 was higher than the statutory federal income tax rate primarily due to the net impact of the U.S. Internal Revenue Service (IRS) audit settlement in the second quarter of 2010, partially offset by geographical mix of the Company s pre-tax income. The effective income tax rate for the three and nine months ended October 2, 2009 was lower than the statutory federal income tax rate primarily due to the geographical mix of the Company s pre-tax income.

OFF-BALANCE SHEET FINANCINGS AND LIABILITIES

Other than lease commitments incurred in the normal course of business, we do not have any off-balance sheet financing arrangements or liabilities, guarantee contracts, retained or contingent interests in transferred assets, or any obligation arising out of a material variable interest in an unconsolidated entity. We do not have any majority-owned subsidiaries that are not included in the condensed consolidated financial statements. Additionally, we do not have any interest in, or relationship with, any special purpose entities.

In the normal course of business to facilitate sales of its products, we indemnify other parties, including customers, lessors, and parties to other transactions with us, with respect to certain matters. We have agreed to hold the other party harmless against losses arising from a breach of representations or covenants, or out of intellectual property infringement or other claims made against certain parties. These agreements may limit the time within which an indemnification claim can be made and the amount of the claim. In addition, we have entered into indemnification agreements with our officers and directors, and our bylaws contain similar indemnification obligations to our agents.

It is not possible to determine the maximum potential amount under these indemnification agreements due to the limited history of prior indemnification claims and the unique facts and circumstances involved in each particular agreement. Historically, payments made by us under these agreements were not material and no liabilities have been recorded for these obligations on the Condensed Consolidated Balance Sheets as of October 1, 2010 and January 2, 2009.

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LIQUIDITY AND CAPITAL RESOURCES

As of		
(Dollars in thousands)	**October 1, 2010**	**January 1, 2010**
Cash and cash equivalents	$ 211,056	$ 273,848
Total debt	153,093	151,483

Nine Months Ended		
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**
Cash provided by operating activities	$ 87,032	$ 139,121
Cash used in investing activities	(109,137)	(86,687)
Cash provided by (used in) financing activities	(40,464)	14,809
Effect of exchange rate changes on cash and cash equivalents	(223)	5,325
Net increase (decrease) in cash and cash equivalents	$ (62,792)	$ 72,568

Cash and Cash Equivalents

As of October 1, 2010, cash and cash equivalents totaled $211.1 million as compared to $273.8 million at January 1, 2010. Debt was $153.1 million as of October 1, 2010, as compared to $151.5 million at January 1, 2010.

* Our ability to continue to generate cash from operations will depend in large part on profitability, the rate of collections of accounts receivable, our inventory turns, and our ability to manage other areas of working capital.

* We believe that our cash and cash equivalents, together with our revolving credit facilities will be sufficient to meet our anticipated operating cash needs and stock purchases under the stock repurchase program for at least the next twelve months.

* We anticipate that planned capital expenditures primarily for computer equipment, software, manufacturing tools and test equipment, and leasehold improvements associated with business expansion, will constitute a partial use of our cash resources. Decisions related to how much cash is used for investing are influenced by the expected amount of cash to be provided by operations.

Operating Activities

Cash provided by operating activities was $87.0 million for the nine months ended October 1, 2010, as compared to $139.1 million for the nine months ended October 2, 2009. This decrease of $52.1 million was primarily driven by an increase in accounts receivable due to higher revenue, an increase in inventory spending, and the IRS tax settlement, offset by an increase in accounts payable and accrued compensation and benefits.

Investing Activities

Cash used in investing activities was $109.1 million for the nine months ended October 1, 2010, as compared to $86.7 million for the nine months ended October 2, 2009. The increase of $22.5 million was due to higher cash requirements for business and for intangible asset acquisitions.

Financing Activities

Cash used by financing activities was $40.5 million for the nine months ended October 1, 2010, as compared to cash provided of $14.8 million for the nine months ended October 2, 2009. The decrease of $55.3 million was primarily due to the stock repurchases in the first nine months of fiscal 2010.

Accounts Receivable and Inventory Metrics

As of	October 1, 2010	January 1, 2010
Accounts receivable days sales outstanding	66	66
Inventory turns per year	3.9	3.4

Accounts receivable days sales outstanding were both 66 days as of October 1, 2010 and January 2, 2009. Our accounts receivable days sales outstanding is calculated based on ending accounts receivable, net, divided by revenue for the corresponding fiscal quarter, times a quarterly average of 91 days. Our inventory turns were 3.9 As of October 1, 2010, as compared to 3.4 as of January 1, 2010. Our inventory turnover is calculated based on total cost of sales for the most recent twelve months divided by average ending inventory, net, for this same twelve month period.

Debt

As of October 1, 2010, our total debt was comprised primarily of our revolving credit line in the amount of $151.0 million, which was drawn down in the third and the fourth quarters of fiscal 2008. As of October 1, 2010 and January 1, 2010 we had notes payable totaling approximately $2.1 million and $0.5 million, respectively. Our outstanding notes payable as of October 1, 2010 consisted primarily of notes payable to noncontrolling interest holders of one of our consolidated subsidiaries. The notes bear interest at 6% and have undefined payment terms, but are callable with a six month notification. Our outstanding notes payable balance as of January 1, 2010 consisted primarily of government loans to foreign subsidiaries.

On July 28, 2005, we entered into a $200 million unsecured revolving credit agreement (the 2005 Credit Facility) with a syndicate of 10 banks with The Bank of Nova Scotia as the administrative agent. On February 16, 2007, we amended our existing $200 million unsecured revolving credit agreement with a syndicate of 11 banks with The Bank of Nova Scotia as the administrative agent (the 2007 Credit Facility). Under the 2007 Credit Facility, we exercised the option in the existing credit agreement to increase the availability under the revolving credit line by $100 million, for an aggregate availability of up to $300 million, and extended the maturity date of the revolving credit line by 18 months, from July 2010 to February 2012. Up to $25 million of the availability under the revolving credit line may be used to issue letters of credit, and up to $20 million may be used for paying off other debts or loans. The maximum leverage ratio under the 2007 Credit Facility is 3.00:1.00. The funds available under the new 2007 Credit Facility may be used by us for acquisitions, stock repurchases, and general corporate purposes. As of August 20, 2008, we amended the 2007 Credit Facility to allow us to redeem, retire or purchase Trimble common stock without limitation so long as no default or unmatured default then existed, and leverage ratio for the two most recently completed periods was less than 2.00:1.00. In addition, the definition of the fixed charge was amended to exclude the impact of redemptions, retirements, or purchases of Trimble common stock from the fixed charges coverage ratio. For additional discussion of our debt, see Note 8 of Notes to the Condensed Consolidated Financial Statements.

In addition, during the first quarter of fiscal 2007 we incurred a five-year term loan under the 2007 Credit Facility in an aggregate principal amount of $100 million, which was repaid in full during fiscal 2008.

We may borrow funds under the 2007 Credit Facility in U.S. Dollars or in certain other currencies, and borrowings will bear interest, at our option, at either: (i) a base rate, based on the administrative agent s prime rate, plus a margin of between 0% and 0.125%, depending on our leverage ratio as of our most recently ended fiscal quarter, or (ii) a reserve-adjusted rate based on the London Interbank Offered Rate (LIBOR), Euro Interbank Offered Rate (EURIBOR), Stockholm Interbank Offered Rate (STIBOR), or other agreed-upon rate, depending on the currency borrowed, plus a margin of between 0.625% and 1.125%, depending on our leverage ratio as of the most recently ended fiscal quarter. Our obligations under the 2007 Credit Facility are guaranteed by certain of our domestic subsidiaries.

The 2007 Credit Facility contains customary affirmative, negative and financial covenants including, among other requirements, negative covenants that restrict our ability to dispose of assets, create liens, incur indebtedness, repurchase stock, pay dividends, make acquisitions, make investments, enter into mergers and consolidations, and make capital expenditures, within certain limitations, and financial covenants that require the maintenance of leverage and fixed charge coverage ratios. The 2007 Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, breach of covenants, inaccuracy of representations and warranties, cross defaults to certain other indebtedness, bankruptcy and insolvency events, material judgments, and events constituting a change of control. Upon the occurrence and during the continuance of an event of default, interest on the obligations will accrue at an increased rate and the lenders may accelerate our obligations under the 2007 Credit Facility, however that acceleration will be automatic in the case of bankruptcy and insolvency events of default. As of October 1, 2010 we were in compliance with all financial debt covenants.

RECONCILIATION OF GAAP TO NON-GAAP FINANCIAL MEASURES

The following presentation includes non-GAAP measures. Our non-GAAP measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures. The non-GAAP financial measures included in the below tables are non-GAAP gross margin, non-GAAP operating expenses, non-GAAP operating income, non-GAAP non-operating income, net, non-GAAP net income, non-GAAP diluted net income per share and operating leverage, and non-GAAP segment operating income before corporate allocations. These non-GAAP measures can be used to evaluate our historical and prospective financial performance, as well as our performance relative to competitors. We believe some of its investors track our core operating performance as a means of evaluating our performance in the ordinary, ongoing, and customary course of our operations. Management also believes that looking at our core operating performance provides a supplemental way to provide consistency in period to period comparisons. Accordingly, management excludes from non-GAAP those items relating to restructuring, amortization of purchased intangibles, stock based compensation, amortization of acquisition-related inventory step-up, non-recurring acquisition costs, and a $27.5 million charge associated with the IRS settlement, which we believe are not indicative of our core operating performance. For a detailed explanations of the adjustments made to comparable GAAP measures, see items (A) (G) below.

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		Three Months Ended				Nine Months Ended			
		Oct-1, 2010		Oct-2, 2009		Oct-1, 2010		Oct-02, 2009	
		Dollar Amount	% of Revenue	Dollar Amount	% of Revenue	Dollar Amount	% of Revenue	Dollar Amount	% of Revenue
GROSS MARGIN:									
GAAP gross margin:		$ 159,748	50.2%	$ 132,458	49.1%	$ 482,171	49.7%	$ 419,216	49.4%
Restructuring	(A)	52	0.0%	270	0.1%	150	0.0%	3,333	0.4%
Amortization of purchased intangibles	(B)	6,356	2.0%	5,661	2.1%	17,915	1.8%	16,421	1.9%
Stock-based compensation	(C)	485	0.2%	453	0.2%	1,472	0.2%	1,368	0.2%
Amortization of acquisition-related inventory step-up	(D)	69	0.0%		0.0%	140	0.0%	470	0.0%
Non-GAAP gross margin:		$ 166,710	52.4%	$ 138,842	51.5%	$ 501,848	51.7%	$ 440,808	51.9%
OPERATING EXPENSES:									
GAAP operating expenses:		$ 128,078	40.3%	$ 112,293	41.6%	$ 373,825	38.5%	$ 346,073	40.8%
Restructuring	(A)	(238)	-0.1%	(872)	-0.3%	(1,244)	-0.1%	(5,797)	-0.7%
Amortization of purchased intangibles	(B)	(8,078)	-2.5%	(7,912)	-3.0%	(24,250)	-2.5%	(22,411)	-2.7%
Stock-based compensation	(C)	(5,055)	-1.6%	(4,088)	-1.5%	(14,693)	-1.5%	(11,953)	-1.4%
Stock-based compensation	(E)	(569)	-0.2%	(577)	-0.2%	(3,071)	-0.3%	(3,382)	-0.4%
Non-GAAP operating expenses:		$ 114,138	35.9%	$ 98,844	36.6%	$ 330,567	34.1%	$ 302,530	35.6%
OPERATING INCOME:									
GAAP operating income:		$ 31,670	10.0%	$ 20,165	7.5%	$ 108,346	11.2%	$ 73,143	8.6%
Restructuring	(A)	290	0.1%	1,142	0.4%	1,394	0.1%	9,130	1.1%
Amortization of purchased intangibles	(B)	14,434	4.5%	13,573	5.0%	42,165	4.3%	38,832	4.6%
Stock-based compensation	(C)	5,540	1.7%	4,541	1.7%	16,165	1.7%	13,321	1.6%
Amortization of acquisition-related inventory step-up	(D)	69	0.0%		0.0%	140	0.0%	470	0.0%
Stock-based compensation	(E)	569	0.2%	577	0.2%	3,071	0.3%	3,382	0.4%
Non-GAAP operating income:		$ 52,572	16.5%	$ 39,998	14.8%	$ 171,281	17.6%	$ 138,278	16.3%
NON-OPERATING INCOME, NET:									
GAAP non-operating income, net:		$ 6,659		$ 1,396		$ 10,480		$ 1,795	
Non-recurring acquisition (gains) costs	(E)	(3,022)				(3,212)		(386)	
Non-GAAP non-operating income, net:		$ 3,637		$ 1,396		$ 7,268		$ 1,409	
NET INCOME:									
GAAP net income attributable to Trimble Navigation Ltd.		$ 32,845		$ 15,577		$ 67,096		$ 53,899	
Restructuring	(A)	290		1,142		1,394		9,130	
Amortization of purchased intangibles	(B)	14,434		13,573		42,165		38,832	
Stock-based compensation	(C)	5,540		4,541		16,165		13,321	
Amortization of acquisition-related inventory step-up	(D)	69				140		470	
Non-recurring acquisition (gains) costs	(E)	(2,453)		577		(141)		2,996	
Income tax effect on non-GAAP adjustments	(F)	(2,560)		(5,256)		15,591		(17,411)	
Non-GAAP net income attributable to Trimble Navigation Ltd.		$ 48,165		$ 30,154		$ 142,410		$ 101,237	

DILUTED NET INCOME PER SHARE:

GAAP diluted net income per share attributable to Trimble Navigation Ltd.		$ 0.27		$ 0.13		$ 0.54		$ 0.44	
Restructuring	(A)			0.01		0.01		0.07	
Amortization of purchased intangibles	(B)	0.12		0.11		0.34		0.32	
Stock-based compensation	(C)	0.04		0.04		0.13		0.11	
Amortization of acquisition-related inventory step-up	(D)								
Non-recurring acquisition (gains) costs	(E)	(0.02)						0.03	
Income tax effect on non-GAAP adjustments	(F)	(0.02)		(0.04)		0.13		(0.14)	
Non-GAAP diluted net income per share attributable to Trimble Navigation Ltd.		$ 0.39		$ 0.25		$ 1.15		$ 0.83	
OPERATING LEVERAGE:									
Increase in non-GAAP operating income		$ 12,574				$ 33,003			
Increase in revenue		$ 48,497				$ 121,858			
Operating leverage (increase in non-GAAP operating income as a % of increase in revenue)		25.9%				27.1%			
			% of Segment Revenue		**% of Segment Revenue**		**% of Segment Revenue**		**% of Segment Revenue**
SEGMENT OPERATING INCOME:									
Engineering and Construction									
GAAP operating income before corporate allocations:		$ 36,589	19.3%	$ 21,131	14.1%	$ 89,317	16.7%	$ 42,800	10.1%
Stock-based compensation	(G)	1,891	1.0%	1,563	1.1%	5,494	1.0%	4,302	1.0%
Non-GAAP operating income before corporate allocations:		$ 38,480	20.3%	$ 22,694	15.2%	$ 94,811	17.7%	$ 47,102	11.1%
Field Solutions									
GAAP operating income before corporate allocations:		$ 21,027	31.3%	$ 16,286	29.3%	$ 89,320	36.7%	$ 88,637	37.8%
Stock-based compensation	(G)	464	0.7%	293	0.5%	1,397	0.6%	775	0.3%
Non-GAAP operating income before corporate allocations:		$ 21,491	32.0%	$ 16,579	29.8%	$ 90,717	37.3%	$ 89,412	38.1%
Mobile Solutions									
GAAP operating income (loss) before corporate allocations:		$ (83)	-0.2%	$ 3,367	8.5%	$ 2,140	1.9%	$ 10,163	8.7%
Stock-based compensation	(G)	827	2.2%	958	2.4%	2,246	2.0%	3,205	2.7%
Non-GAAP operating income before corporate allocations:		$ 744	2.0%	$ 4,325	10.9%	$ 4,386	3.9%	$ 13,368	11.4%
Advanced Devices									
GAAP operating income before corporate allocations:		$ 4,073	17.2%	$ 4,488	17.9%	$ 14,879	19.1%	$ 13,633	18.7%
Stock-based compensation	(G)	450	1.9%	397	1.6%	1,350	1.8%	1,068	1.5%
Non-GAAP operating income before corporate allocations:		$ 4,523	19.1%	$ 4,885	19.5%	$ 16,229	20.9%	$ 14,701	20.2%

A. *Restructuring*. Included in our GAAP presentation of cost of sales and operating expenses, restructuring costs recorded are primarily for employee compensation resulting from reductions in employee headcount in connection with our company restructurings. We exclude restructuring costs from our non-GAAP measures because we believe they are not indicative of our core operating performance.

B.

Amortization of purchased intangibles. Included in our GAAP presentation of cost of sales and operating expenses, amortization of purchased intangibles recorded arises from prior acquisitions and are non-cash in nature. We exclude these expenses from our non-GAAP measures because we believe they are not indicative of our core operating performance.

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C. *Stock-based compensation*. Included in our GAAP presentation of cost of sales and operating expenses, stock-based compensation consists of expenses for employee stock options and awards and purchase rights under our employee stock purchase plan. We exclude stock-based compensation expense from our non-GAAP measures because some investors may view it as not reflective of our core operating performance as it is a non-cash expense. For the three months ended October 1, 2010 and October 2, 2009, stock-based compensation was allocated as follows:

	Three Months Ended		Nine Months Ended	
(Dollars in thousands)	**October 1, 2010**	**October 2, 2009**	**October 1, 2010**	**October 2, 2009**
Cost of sales	$ 485	$ 453	$ 1,472	$ 1,368
Research and development	968	866	2,899	2,504
Sales and Marketing	1,283	1,134	4,013	3,200
General and administrative	2,804	2,088	7,781	6,249
	$ 5,540	$ 4,541	$ 16,165	$ 13,321

D. *Amortization of acquisition-related inventory step-up*. The purchase accounting entries associated with our business acquisitions require us to record inventory at its fair value, which is sometimes greater than the previous book value of the inventory. Included in our GAAP presentation of cost of sales, the increase in inventory value is amortized to cost of sales over the period that the related product is sold. We exclude inventory step-up amortization from our non-GAAP measures because we do not believe it is indicative of our core operating performance.

E. *Non-recurring acquisition (gains) costs*. Included in our GAAP presentation of operating expenses and non-operating income, net, non-recurring acquisition costs consist of external and incremental costs resulting directly from merger and acquisition activities such as legal, due diligence and integration costs. Also included are unusual acquisition related items such as adjustments to the fair value of earnout liabilities and payments made to settle earnout and holdback disputes. We exclude these items because they are non-recurring and unique to specific acquisitions and are not indicative of our core operating performance.

F. *Income tax effect on non-GAAP adjustments.* This amount adjusts the provision for income taxes to reflect the effect of the non-GAAP adjustments on non-GAAP net income. In addition, the nine months ended October 1, 2010 include the net impact of the $27.5 million associated with the IRS audit settlement.

G. *Stock-based Compensation*. The amounts consist of expenses for employee stock options and awards and purchase rights under our employee stock purchase plan. As referred to above we exclude stock-based compensation here because investors may view it as not reflective of our core operating performance. However, management does include stock-based compensation for budgeting and incentive plans as well as for reviewing internal financial reporting. We discuss our operating results by segment with and without stock-based compensation expense, as we believe it is useful to investors. Stock-based compensation not allocated to the reportable segments was approximately $1.9 million and $1.3 million for the three months ended October 1, 2010 and October 2, 2009, respectively and $5.7 million and $4.0 million for the nine months ended October 1, 2010 and October 2, 2009, respectively.

Non-GAAP Operating Income

Non-GAAP operating income increased by $12.6 million for the three months ended October 1, 2010, as compared to the corresponding period in the prior year. Non-GAAP Operating income as a percentage of total revenue was 16.5% for the three months ended October 1, 2010, as compared to 14.8% for the three months ended October 2, 2009. Non-GAAP operating income increased by $33.0 million for the nine months ended October 1, 2010, as compared to the corresponding period in the prior year. Non-GAAP Operating income as a percentage of total revenue was 17.6% for the nine months ended October 1, 2010, as compared to 16.3% for the nine months ended October 2, 2009.The increase in operating income for both the three and nine month periods was primarily driven by higher revenue in Engineering and Construction. The increase in operating income percentage for both the three and nine month periods was primarily due to increased operating leverage in Engineering and Construction.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We use certain derivative financial instruments to manage these risks. We do not use derivative financial instruments for speculative purposes. All financial instruments are used in accordance with policies approved by our Board of Directors.

Market Interest Rate Risk

There have been no significant changes to our market interest rate risk assessment. Refer to our 2009 Annual Report on Form 10-K.

Foreign Currency Exchange Rate Risk

There have been no significant changes to our foreign currency exchange rate risk assessment. Refer to our 2009 Annual Report on Form 10-K.

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ITEM 4. CONTROLS AND PROCEDURES

(a) Disclosure Controls and Procedures.

The management, with the participation of our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this report. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, our disclosure controls and procedures are effective.

(b) Internal Control Over Financial Reporting.

There have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

From time to time, we are involved in litigation arising out of the ordinary course of our business. There are no material legal proceedings, other than ordinary routine litigation incidental to the business, to which we or any of our subsidiaries is a party or of which any of our or their property is subject.

ITEM 1A. RISK FACTORS

A description of factors that could materially affect our business, financial condition, or operating results is included under Risk and Uncertainties in Item 1A of Part I of our 2009 Annual Report on Form 10-K and is incorporated herein by reference. There have been no material changes to the risk factor disclosure since our 2009 Annual Report on Form 10-K. The risk factors described in our Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial conditions and/or operating results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

(a) None

(b) None

(c) The following table provides information relating to our purchases of equity securities for the third quarter of fiscal 2010.

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program (1)
July 3, 2010 August 6, 2010	216,378	28.40	216,378	50,259,023
August 7, 2010 September 3, 2010				50,259,023
September 4, 2010 October 1, 2010				50,259,023
Total	216,378	28.40	216,378	

(1) In January 2008, the Company announced that its board of directors had authorized a stock repurchase program for up to $250 million, effective February 1, 2008. The timing and actual number of shares repurchased will depend on a variety of factors including price, regulatory requirements, capital availability, and other market conditions. The program does not require the purchase of any minimum number of shares and may be suspended or discontinued at any time without public notice.

ITEM 6. EXHIBITS

3.1	Restated Articles of Incorporation of the Company filed June 25, 1986. (2)
3.2	Certificate of Amendment of Articles of Incorporation of the Company filed October 6, 1988. (2)
3.3	Certificate of Amendment of Articles of Incorporation of the Company filed July 18, 1990. (2)
3.4	Certificate of Amendment of Articles of Incorporation of the Company filed May 29, 2003. (3)
3.5	Certificate of Amendment of Articles of Incorporation of the Company filed March 4, 2004. (4)
3.6	Certificate of Amendment of Articles of Incorporation of the Company filed February 21, 2007. (6)
3.7	Bylaws of the Company, amended and restated through February 24, 2010. (5)
4.1	Specimen copy of certificate for shares of Common Stock of the Company. (1)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated November 8, 2010. (7)
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 dated November 8, 2010. (7)
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated November 8, 2010. (7)
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 dated November 8, 2010. (7)
101.INS	XBRL Instance Document. (8)
101.SCH	XBRL Taxonomy Extension Schema Document. (8)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document. (8)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document. (8)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document. (8)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document. (8)

(1) Incorporated by reference to exhibit number 4.1 to the registrant s Registration Statement on Form S-1, as amended (File No. 33-35333), which became effective July 19, 1990.

(2) Incorporated by reference to identically numbered exhibits to the registrant s Annual Report on Form 10-K for the fiscal year ended January 1, 1999.

(3) Incorporated by reference to exhibit number 3.5 to the registrant s Quarterly Report on Form 10-Q for the quarter ended July 4, 2003.

(4) Incorporated by reference to exhibit number 3.6 to the registrant s Quarterly Report on Form 10-Q for the quarter ended April 2, 2004.

(5) Incorporated by reference to exhibit number 3.1 to the Company s Current Report on Form 8-K, filed March 2, 2010.

(6) Incorporated by reference to exhibit number 3.7 to the Company s Quarterly Report on Form 10-Q for the quarter ended March 30, 2007.

(7) Filed herewith.

(8) Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not filed and otherwise are not subject to liability.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

TRIMBLE NAVIGATION LIMITED
(Registrant)

By: /s/ RAJAT BAHRI
Rajat Bahri
Chief Financial Officer
(Authorized Officer and Principal

Financial Officer)

DATE: November 8, 2010

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(8)	Pursuant to applicable securities laws and regulations, the Company is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Company has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. Users of this data are advised that, pursuant to Rule 406T, these interactive data files are deemed not

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