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TSO - Q4 2011 TESORO CORPORATION EARNINGS CONFERENCE CALL

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OVERVIEW:

TSO reported 4Q11 net loss of \$124m or \$0.89 per diluted share.



CORPORATE PARTICIPANTS

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Gregory Goff *Tesoro Corp - Pres, CEO*

Scott Spendlove *Tesoro Corp - SVP, CFO*

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CONFERENCE CALL PARTICIPANTS

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Chi Chow *Macquarie Research - Analyst*

Jeff Dietert *Simmons & Company International - Analyst*

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Doug Leggate *BofA Merrill Lynch - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the fourth quarter 2011 Tesoro Corporation earnings conference call. My name is Chanel, and I will be your operator for today. At this time, all participants are in listen-only mode. Later, we will conduct a question and answer session.

(Operator Instructions).

As a reminder, this conference is being recorded for replay purposes. I would now like to turn the conference over to your host for today, Mr. Louie Rubiola, Director of Investor Relations. Please proceed.

Louie Rubiola - Tesoro Corp - Director, IR

Thank you, Chanel. Good morning, everyone, and welcome to today's conference call to discuss our fourth quarter and full-year 2011 earnings. Joining me today are Greg Goff, President and CEO, Dan Romasko, Executive Vice President of Operations, and Scott Spendlove, Senior Vice President and CFO. While we will not be referencing slides during the call, we do have a set of slides which was filed with the SEC today. These slides, along with other financial disclosure and reconciliations for non-GAAP financial measures should help you in analyzing our results, and can be found on our website at www.tsocorp.com. Please refer to the forward-looking statements in the earnings slides, which says statements made during this call that refer to management's expectations and/or future predictions are forward-looking statements intended to be covered by the Safe Harbor provisions of the Securities Act, as there are many factors which could cause results to differ from our expectations. With that, I'll turn the call over to Greg.

Gregory Goff - Tesoro Corp - Pres, CEO

Thanks, Louie. Good morning, everyone, and thank you for taking the time to join us on the call today. You have our earnings release, and Scott will go over some of the details in a moment. Despite a weak fourth quarter, 2011 was an outstanding year for Tesoro. We delivered improved



reliability and utilization, reduced operating costs on a per barrel basis, and greatly exceeded our EBITDA improvement targets. The result was a net earnings that were comparable to 2007, when the Tesoro index was nearly \$4.50, or 40% higher. We successfully launched Tesoro Logistics, drove increased refining and marketing integration, reduced debt, and developed several strategic capital projects, that will create significant value over the next few years.

I'll come back and talk more about our full-year results in just a minute. But first, let me comment on the fourth quarter. The fourth quarter experienced very poor West Coast crack spreads, and significant volatility in crude oil price differentials. In addition to gasoline crack weakness, we saw unusually high prices for heavy California crude oil, with the discounts averaging less than \$1.00 per barrel relative to Brent, compared to \$7.00 to \$10.00 per barrel a year ago, and in the third quarter. Offsetting this weakness were Mid-Continent crack spreads, that despite a sharp drop in the Brent WTI differential, were still more than double what they were last year. Taken together, the Tesoro index for the fourth quarter averaged \$7.50 per barrel, up slightly from a year ago. Our realized margin on the other hand, was just \$6.00 per barrel, or about 80% of the Tesoro index.

The most significant driver of lower realized margins in the quarter was the collapse of the WTI to Brent crude oil spread, which fell more -- from \$26.00 per barrel at the end of September, to \$8.00 per barrel at the end of December. Beyond the obvious effect this had on our benchmark margins this \$18.00 per barrel narrowing of the differential, reduced the margin on certain long-haul foreign crude oil barrels, that price off water-borne benchmarks such as Dubai and Brent but are indexed to WTI. The value of these barrels appreciated, along with the WTI, without a corresponding increase in product values. For the fourth quarter, we calculate the negative impact of the WTI Brent collapse related to these foreign barrels to be about \$125 million, which explains most of the under-performance in our overall capture rate for the quarter. For the full-year, this effect was a net positive, though the gains we saw in the first nine months of the year were offset by higher prices for Bakken and Canadian light sweet relative to WTI.

Plant conversion unit downtime in the fourth quarter, and preparation for downtime scheduled for the first quarter of 2012 resulted in lower light product yields, and a lighter overall crude slate, and can be seen lower capture rates in our California and Pacific Northwest regions. That work reduced fourth quarter total throughput to 567,000 barrels per day, or 85% of total capacity. Manufacturing costs in the fourth quarter averaged \$5.03 per barrel, up \$0.46 from the third quarter, reflecting higher maintenance spending and lower refinery throughput. Retail fuel sales volumes were up 14% year-over-year for the quarter, with the addition of some 300 stations in the Mid-Continent earlier in the year. Same-store fuel sales during the quarter were essentially flat, relative to last year. Retail marketing margins were up during the quarter, both sequentially and year-over-year. Clearly, the fourth quarter performance was disappointing, but I remain very pleased with what we were able to achieve in 2011. We captured the strong margins available in the market, and added to them by driving fundamental improvements in our business. Excluding the impact of the 2010 Anacortes incident, we increased refinery availability to 97%, and increased refining to refinery utilization to 87%, a 12% increase. And we reduced manufacturing costs per barrel by 15%.

When we met with you in December of 2010, we committed that we would deliver over \$220 million in year-over-year EBITDA growth. I am very pleased to report to you today that we exceeded our goal, and you can see the improvement in our results. Full-year 2011 EBITDA was up more than \$900 million over 2010. Insurance proceeds and throughput gains related to the Anacortes incident account for about \$[150] million of that improvement, and market-related gains account for another \$400 million. That leaves some \$[350] million in higher EBITDA, directly related to the improvement initiatives we have pursued throughout the year. The strong performance of the year resulted in significant free cash flow, that allowed us to repurchase \$328 million in outstanding debt during the year, reducing our total debt to total capitalization to 30% down from 38% at the end of 2010.

As we discussed at the Analyst meeting at the end of 2011, our plans for 2012 are to continue to build on this strength, driving \$150 million to \$200 million of additional EBITDA this year. We've announced plans to invest in the business in ways that further reduce our feedstock cost, improve our yields, and reduce expenses. Those capital spending plans have not changed from what we announced in December, and we've reaffirm our outlook for 2012 capital spending of \$670 million, and turnaround spending of about \$300 million. We have an ambitious growth plan for Tesoro logistics that we expect will drive EBITDA to about \$100 million by 2013, nearly doubling it from the time of the IPO. And as the market value of Tesoro Logistics continues to grow, that growth accrues to Tesoro at an accelerated pace as the general partnership distributions move into the high splits. And as we mentioned in our press release, we recently closed the acquisition of 49 Albertsons Fuel Express stations from SUPERVALU, increasing our refining and marketing integration, adding additional 500,000 barrels per day of ratable, profitable offtake. To reiterate our strategic focus, we remain focused on driving improvements in the base business, generating free cash flow, strengthening the competitive position of the

Company, and increasing shareholder value. With that, I'll turn the call over to Scott Spendlove, our CFO, for a more detailed discussion of our quarterly results, and to provide guidance for the first quarter. Scott?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Thanks, Greg. As we reported last night, our fourth quarter net loss was \$124 million or \$0.89 per diluted share. That compares to an adjusted net loss in the fourth quarter last year of \$19 million, or \$0.13 per diluted share. Special items last year included after-tax income of \$0.27 per diluted share, resulting from business interruption and property damage insurance proceeds, net of costs related to repair work at the Anacortes refinery, and non-cash after-tax expenses of \$0.12 per diluted share related to potential legal claims of an Alaskan pipeline settlement, and a write-off of goodwill at the Hawaii refinery. Our corporate and unallocated costs for the quarter were \$36 million, before \$2 million in corporate depreciation, and \$21 million in non-cash stock-based compensation accruals, primarily related to stock appreciation rights.

Fourth-quarter results were \$0.09 below the low end of our guidance range, because of the combined differences in volume, yield, and pricing assumptions, relative to actual results for the quarter. Capital expenditures for the fourth quarter were \$129 million, and turnaround spending was \$36 million. We ended the quarter with a cash balance of \$900 million, down from \$1.1 billion at the end of the third quarter. The decrease in cash of more than \$200 million reflects negative EBITDA of \$56 million, capital and turnaround spending of \$165 million, and cash interest and taxes of \$107 million. Working capital and financing activities, which included borrowings under the Tesoro Panama revolver, added \$93 million. We remained undrawn on the corporate revolver, with over \$800 million of revolving credit capacity at the end of the year.

Turning to the first quarter, this is typically a weak gasoline demand period, both nationally and in PADD 5, with demand typically falling 1% to 3% from the already weak fourth quarter. From a supply and demand perspective, the West Coast is relatively imbalanced, providing support to cracks, which are up slightly from the fourth quarter of 2011. Regarding crude oil price differentials, the relative discount of California heavy crude oil has returned to a more normal level, having averaged a \$7.00 per barrel discount to Brent so far this year. The WTI Brent -- WTI to Brent crude oil spread has also stabilized in the \$10.00 per barrel range, and was as light as \$14.00 yesterday.

I'll close with guidance for the -- for first quarter modeling purposes. We estimate throughput to be, in thousands of barrels per day, 145 to 155 in the Pacific Northwest, 65 to 75 in the Mid-Pacific, 110 to 120 in the Mid-Continent, and 210 to 220,000 (sic -- see earnings slide) barrels per day in the California region. Manufacturing cost guidance for the first quarter, in dollars per barrel is as follows, \$4.10 in the Pacific Northwest, \$3.65 in the Mid-Pacific, \$3.50 in the Mid-Continent, and \$7.00 per barrel in the California region. Throughputs in California will be affected by plant turnaround activity at our Martinez refinery. Our depreciation for refining is estimated at \$93 million. Additional first quarter guidance items include estimated corporate expenses, excluding depreciation of \$36 million, and interest expense before interest income of \$36 million. And with that, I'll turn the call back over to Greg for closing comments. Greg?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Thanks, Scott. We are pleased with our 2011 results, but that was the first year of a multi-year plan to drive significant improvement in the profitability of the Company. We are guided by our strategic priorities, as we indicated in December of last year. As we look to 2012, we have an ambitious capital investment plan, and a heavy turnaround year. Execution is our top priority. With that, we'll now take questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions).



Your first question comes from the line of Ed Westlake, Credit Suisse.

Edward Westlake - *Credit Suisse - Analyst*

Hi, good morning, Greg, and everyone. Lots of strategic progress last year. Obviously, you've announced Hawaii, a potential sale there. Can you just discuss sort of timing and levels of interest in that process?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Good morning, Ed. It's -- you're right. We did announce the sale of the Hawaii asset. And we're actually in the very early stages of going to market with the asset. We do intend to conduct an auction process, and are actually moving along in that process. And it's really too early to gauge any interest, since the bankers and that haven't really gone to the market. But we'll monitor that as we go through the year.

Edward Westlake - *Credit Suisse - Analyst*

And then just picking up on a comment you made at the Analyst Day about your SWAT teams going around refineries and finding ways to improve operations. You had two more refineries, I think, to cycle through in the first quarter. Might also be a bit early, but any comments on the opportunities you found, and how -- what your thinking is, if some of those are say, larger capital products, to feather those into the capital spending, if you have \$670 million this year, and then \$545 million next?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. We -- it's too early. I mean, the teams are actually in the process of being out at the refineries right now. And it takes us a little bit of time to do that. It's not very likely that we would execute any other projects, just because we're in -- we already have the Mandan refinery, the work we're doing at Salt Lake, Los Angeles, the Anacortes, so those would come into our future plans, as they complete the work, sometime during the first quarter.

Edward Westlake - *Credit Suisse - Analyst*

Okay. And then a final quick one. Demand in California, you said same-store sales flat in Q4. Any color on how January is shaping up?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. Let me let Dan comment on that, Ed.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, sure. Same-store sales, January year-to-date are somewhere between flat to down 1%, which is a bit better than what PADD5 looks like, and obviously, quite a bit better than US average.

Edward Westlake - *Credit Suisse - Analyst*

Which seems bizarre, in the sense of that the US average seems very low. Are you seeing any funnies in your region, in the data on the DOE or --?



Dan Romasko - *Tesoro Corp - EVP, Operations*

Tough to tell. Obviously, the DOE data is quite concerning, but we don't have any unique insight there.

Edward Westlake - *Credit Suisse - Analyst*

Okay. Thank you.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Thanks, Ed.

Operator

Your next question comes from the line of Chi Chow of Macquarie Capital.

Chi Chow - *Macquarie Research - Analyst*

Great, thank you. I'd like to focus in on the three strategic projects that are set for completion this year, which I believe are the Bakken crude supply at Anacortes, the Mandan expansion, and the Wilmington backing unit. Can you give us an update on how things are progressing, and are there any changes in the outlook for cost or earnings accretion?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Morning, Chi, this is Greg. Let me turn the question over to Dan, and let Dan respond to your question.

Chi Chow - *Macquarie Research - Analyst*

Okay.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, sure. All great projects, all on schedule. No new news on project costs that are of concern. Permits are fully received from Mandan, and we're -- in construction window still expect completion to occur by the end of second quarter, so that project is good to go. LA vac tower is also in progress, and no material cost increase there, and the EBITDA generation still looks solid. In fact, the tower itself, has been shipped from Europe, and is in route to LA. And Anacortes, we received the permits necessary to begin construction on the offloading facility for rail. So that's great news, and work is commencing. So we expect that to be operational fourth quarter.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Let me just add to that, we also have our railcars on delivery time, so that we have acquired the railcars to do that. So everything looks good from an Anacortes standpoint.

Chi Chow - *Macquarie Research - Analyst*

Okay, great. Thanks. A couple of financial questions. Any thoughts on reestablishing the dividends at this point?



Gregory Goff - *Tesoro Corp - Pres, CEO*

Chi, at this point in time, with our plans, with our cash position, with the ambitious capital projects that we have, because we believe that they are so attractive, we want to be able to go in and execute the projects, deliver them, and then we will look probably next year, at where we stand. But as we've laid out, between our capital spending and our turnaround spending, we plan to put about \$1 billion into the business this year. And so, we believe we want to just complete that, and then we'll re-look later.

Chi Chow - *Macquarie Research - Analyst*

Okay. And it seems like you've got the cash to at least establish some nominal dividend. Are you keeping some dry powder, on top of the capital spending, on potential acquisitions or anything along those lines?

Gregory Goff - *Tesoro Corp - Pres, CEO*

I mean, we continue to look at opportunities in the market, and we want the financial flexibility, in case opportunities come up, for things that we're -- we see, either for our logistics business or in other parts of the business.

Chi Chow - *Macquarie Research - Analyst*

Okay. And maybe one final one, on the gains associated with the long haul hedges in the first to third quarters, do you have a breakout on those gains by the quarter?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. We can go over that. Dan, would you like to --?

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, I will give it at a high level, and then let Louis give you the details if you want it at a more a deeper level. So Brent TI for the for the first three quarters was \$195 million positive, fourth quarter, unfortunately clawed back \$125 million, but the good news is the full-year was \$70 million positive. And then, on the Bakken and the Canadian light sweet, those differentials worked the opposite direction, relative to the index WTI. Bakken was about \$7.00 differential worse than WTI, having a negative impact of \$110 million in the first nine months. Similarly, Canadian light sweet, WTI, when applied across the one-third volume that's indexed to WTI, and Anacortes, was roughly \$85 million. And if you wanted on a quarter-by-quarter basis, Louis will have the detail. So give him a call.

Chi Chow - *Macquarie Research - Analyst*

Okay. The Bakken and Canadian differentials, those have swung back the other way, from what it looks like here in this year, is that correct?

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes. If you look at the publicly available posted prices, [clear books] actually come back to a more normal ranges, so those relationships are kind of inversely proportionate to what occurs on the Brent TI.



Chi Chow - *Macquarie Research - Analyst*

Okay. Great. Thanks, Dan. Appreciate it.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes.

Operator

Your next question comes from Jeff Dietert of Simmons & Company.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Good morning, Jeff.

Jeff Dietert - *Simmons & Company International - Analyst*

My question regarded -- regards the potential for an improvement in a credit rating, and moving towards investment grade. You highlighted the reduction in debt to total cap, and plans to retire the \$300 million 6.25% notes this year. It doesn't appear you've got -- the next -- or the next senior note is not due until 2015, but what are your thoughts on moving towards an investment grade credit rating? And how does that compare in priority versus a dividend and other factors you're considering?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes, let me ask Scott to respond to your question, Jeff.

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Good morning, Jeff. We visit with rating agencies frequently, and their message has been the same to us over the last several years, which is more diversity of earnings, more complex refining capacity, things that, in our mind don't necessarily drive value, but in their mind mitigate risk, and spread it across the system more fully. And when we finish paying off the 2012, I don't think that we're going to go after additional debt for the sake of investment grade rating. We're using that cash to pay this debt off, because it matures this year, and it puts us in a stronger position financially. But we're not chasing an investment grade rating by paying off debt.

Jeff Dietert - *Simmons & Company International - Analyst*

Thank you. On a second topic, as Chi mentioned, and you spoke about previously, the Bakken spreads have widened a bit. There's been a fair amount of rail capacity, rail loading capacity, that's come into the Bakken, and yet the differentials are pretty wide. Could you talk about the rail industry in the Bakken, and the new capacity, loading capacity that's come on, versus the availability of railcars, and the availability of markets to unload the capacity into -- and how that balance is playing out? It would appear from the wider discounts for Bakken, that even though new capacity is being added, it's not really relieving the pressure on net backs in the Bakken.



Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, I'd say -- this is Dan, let me take a shot at that. I think you're right, if you take a look at the publicly available information, the rail loading capacity likely is going to be more than sufficient to handle the increased production of the Bakken. I think the differentials that we're seeing on Bakken, based on our economics, for our projects, were based upon cost of rail. I think that the control valve on the rail, is railcars themselves, which are in quite short supply. Beyond that, I don't know that we have a lot of unique market intelligence. The good news on offloading piece, which is I think one part of your question is, we've got a solution to that, and it's Anacortes. We also believe that there is some commercially available capacity in the Gulf coast, that we can utilize to complement our loading capabilities in [Rangeland]. Thanks.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks for your comments.

Operator

Your next question comes from the line of Paul Cheng of Barclays Capital.

Paul Cheng - *Barclays Capital - Analyst*

Hi, good morning.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Good morning, Paul.

Paul Cheng - *Barclays Capital - Analyst*

Great number of questions. On the long-haul crude hedges, is -- I presume that most of those foreign crude is priced based off Brent. So is there a thinking in the Company that whether you should shift from WTI into Brent, or that you're going to stick with WTI?

Gregory Goff - *Tesoro Corp - Pres, CEO*

At the current time, Paul, we intend to keep pricing off of WTI. We look at it all the time, but our decision right now, is to continue the approach we've had, is to price off of WTI.

Paul Cheng - *Barclays Capital - Analyst*

Is there any particular reason? I mean, is it -- always there going to be somewhat of a mismatch?

Gregory Goff - *Tesoro Corp - Pres, CEO*

I mean, you had the spread between Brent and TI, like you said. But as we tie, how we look at the overall program, right now, we just continued to use the WTI as our reference price.

Paul Cheng - *Barclays Capital - Analyst*

Let me ask you another way that if, your foreign crude are mostly priced off Brent or mostly priced off WTI?

Gregory Goff - *Tesoro Corp - Pres, CEO*

It's mixed. It's not one or the other. The South Americans are off of TI, different crudes, but it's a mix. It's not predominantly one basis.

Paul Cheng - *Barclays Capital - Analyst*

Okay. On the \$125 million loss related there in the fourth quarter, do you have a breakdown by region?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. Let me let Dan respond to your question, Paul.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Actually, we don't provide the regional information, because of the commercial sensitivity. But if you take a look at our capture rates, I think you'll see the regions that were impacted most significantly.

Paul Cheng - *Barclays Capital - Analyst*

So I presume that is California? But that -- any rough percentage at least?

Dan Romasko - *Tesoro Corp - EVP, Operations*

I'll tell you what, why don't we, let Louie give you that information in a call afterwards?

Paul Cheng - *Barclays Capital - Analyst*

Okay. Greg, I hear you about, from the dividend. I think in the past, fundamentally, the Company believed as a (inaudible) dividend is not most important, and is not going to really have any meaningful benefit, in terms of your shareholder base. Recently, I think Barron's had an interesting article talking about the dividend. And I think a lot of the investors that may echo, saying, that they do want to have a higher dividend on the sustainable basis, and especially as you start to get into the 3% to 4% yield. I want to see that, is that still fundamentally, is the management view that the dividend for this particular industry, is not the most desirable thing, or the most important thing that to pursue?

Gregory Goff - *Tesoro Corp - Pres, CEO*

We've done an extensive amount of work are looking at dividends, stock buybacks, and how we would manage the Company. And we're very aware, of what other people are doing in that, like you said. Our decision really is because we have -- as we look at the market outlook, and as everyone knows the uncertainty with margins and that as we go out, we believe that right now, because of -- in the short-term, and we're just talking right now for the next 12 months, because of our pretty heavy capital program, and the attractiveness of all the projects, they drive exactly what we want to do with reducing crude costs, reducing operating costs, driving energy efficiency, they fundamentally make the business stronger. And because of the amount that we're doing and our overall cash position, that we believe in the short-term, that the best thing for us to do is to invest in these capital projects. Our analysis has also said that, from a dividend standpoint, we don't -- we can't conclude that we would necessarily



attract different investors into the Company, or that they would tell us to do that right now. But we are very aware of what the investment community is saying about dividends.

Paul Cheng - Barclays Capital - Analyst

Okay. Two more, two more quick questions. First, in Hawaii, I don't know, is it just too premature and you may not want to answer that, but in the event, if we cannot find a reasonable offer, what maybe the next steps in terms of that facility?

Gregory Goff - Tesoro Corp - Pres, CEO

I think it's a good question, Paul, because of the nature of asset. But and we have worked going on, to look at every possibility of what we do, to make that a more attractive asset. And it's just -- it's too early to comment on that. As we need to let the process work, and see what type of interest we have from purchasers. But at the same time, we will explore all possibilities with the asset.

Paul Cheng - Barclays Capital - Analyst

Greg, when you're going to open the data room?

Gregory Goff - Tesoro Corp - Pres, CEO

We're going to be ready sometime in the first quarter, with what we have going on with -- through the process. And that like I mentioned, it will be an auction process, and it will be ready sometime by the end of the first quarter.

Paul Cheng - Barclays Capital - Analyst

A final question. On the rail project to ship from Bakken into Anacortes, is there a breakeven requirement, in terms of the ANS Bakken (inaudible), or that we should be aware on that project? Or I presume that that's one, but I mean can you share with us, that what -- at what spread that is the minimum that you need, in order for the project to be economic?

Dan Romasko - Tesoro Corp - EVP, Operations

Sure. I'll take that one. The economics are actually based on an assumption of an even price between ANS and Bakken, and actual project economics generated, were based upon the yield improvement of the Bakken relative to the ANS. So obviously, that project looks quite attractive today.

Paul Cheng - Barclays Capital - Analyst

Sure. But at what point, that they won't be attractive? That's my question.

Dan Romasko - Tesoro Corp - EVP, Operations

Oh.



Paul Cheng - *Barclays Capital - Analyst*

So if that when ANS is selling at a discount to Bakken by \$2.00 -- or just trying to get some understanding, that, how big is the cushion that we have?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Probably at least \$2.00, probably closer to \$4.00.

Paul Cheng - *Barclays Capital - Analyst*

Okay, very good. Thank you.

Operator

Your next question comes from Sam Margolin of Global Hunter Securities.

Sam Margolin - *Global Hunter Securities, LLC - Analyst*

Good morning.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Hi, Sam.

Sam Margolin - *Global Hunter Securities, LLC - Analyst*

This -- my question is related to the long-haul WTI index barrels. With the capital program, these are important projects that require commitment, and the CapEx acceleration is pretty steep. Is there any initiatives to move away from these riskier longer haul crudes, and kind of stick to more visible indices, even if it's at the risk of losing some margin potential in any given quarter? Just because with Brent WTI, up here at 15 again, this could theoretically repeat itself, if there was ever a compression event.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes, there is -- there is -- we have no intention to move away from the most attractive crude supplier system, and then we'll manage the price risk, on how we price them. But we absolutely need to go out, and drive the best capture that we can, by the crudes that we bring in to the refineries.

Sam Margolin - *Global Hunter Securities, LLC - Analyst*

Okay. And can you disclose which exporters still use a WTI benchmark for the long haul barrels? Is it mainly in the Middle East or Pacific Rim, or where do these like WTI plus 20 barrels come from?

Gregory Goff - *Tesoro Corp - Pres, CEO*

A lot South America does WTI, and then it's different, in different places. It's not predominate in any one place, it depends on your agreements with the different producers.



Sam Margolin - *Global Hunter Securities, LLC - Analyst*

Okay. And last one, just on logistics, you talked about the EBITDA ramp up. I'm sorry if I missed this, but we -- the drop downs you talked about are the Marine terminal in California, and the Bakken rail link. Is there anything else that you're in a position to discuss today?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Let me just clarify, Sam. We have said publicly, that we will drop down the facility, out at our Martinez refinery this year. We said we would intend to drop down the Anacortes rail facility. That's probably won't happen this year, but that's something we have said, that would be our intention to (inaudible). So in our plans for the \$100 million that you mentioned, we have one drop-down. And the rest of that improvement, is driven by growing our pipeline and gathering business, our terminalling business, it's basically organic growth in the logistics business.

Sam Margolin - *Global Hunter Securities, LLC - Analyst*

Okay. Great. Thank you very much.

Operator

And your next question comes from Doug Leggate of Banc of America.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Well, thank you, good morning, everybody.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Hi, Doug.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Greg, apologies for jumping by to Hawaii for a second, but can you just clarify, I know you don't want to go down the road of options at this point, but do you see any government restrictions, if you did decide that you maybe wanted to close that facility? And related, can you give us an idea that net of payables, what is the current inventory value sitting in that facility? And I've got a couple quick follow-ups, please.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Inventory to support the Hawaii refinery runs between 4.5 million barrels of inventory suit to support that facility. It varies a little between there, but it's a fair amount of inventory to support the Hawaii refinery.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Is that crude and products? Or what -- how does that split down?



Gregory Goff - *Tesoro Corp - Pres, CEO*

That's primarily crude oil.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay. And the crude would generally have a payable associated with it? Is that fair?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. Let me let Scott respond on the --

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Doug, typically working capital for that facility runs on a net basis, right about \$100 million. Inventory less payables, I mean, right about \$100 million.

Doug Leggate - *BofA Merrill Lynch - Analyst*

So if we assume just for -- easy numbers for me, Scott, because as I said, I'm a simple guy, \$4.5 million, a \$100.00, \$450 million, we have \$100 million working capital. Would be fair to say that net inventory values, should you liquidate it, before tax, would be in the somewhere in the \$350 million range?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

No. What I'm saying is our net working capital is about \$100 million and --

Doug Leggate - *BofA Merrill Lynch - Analyst*

Oh, right, so that's not just the payable, that's the -- okay.

Scott Spendlove - *Tesoro Corp - SVP, CFO*

That's all-in.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Receivables, payables, yes.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Great stuff. Any government issues? Have you had discussions with local government, Greg?



Gregory Goff - *Tesoro Corp - Pres, CEO*

We have just informed -- we informed all of our customers, our stakeholders, the government of our intentions to take it to market, with a really commitment to try to sell the assets. And that's the extent of the conversations at this point in time.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Terrific. You mentioned in your prepared remarks, Greg, that is this is a heavy turnaround year. I know you give us some indications of that previously, but I guess you Eagle Point is down in the first quarter. Can you give us an idea of when you say heavy, what are we talking about, in terms of the ratable downtime by facility, as we go through the year, just the big ticket items?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Well, really, the -- we did say Golden Eagle is currently down in the first quarter. That's exactly right. And when we refer to it as heavy, we really look at it from a spend standpoint, Doug. So we did say \$300 million of turnaround spending for 2011 is our plan. And one of the biggest parts of our turnaround is in Golden Eagle right now.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Right. So Golden Eagle is done. Is Wilmington is clear of turnarounds this year? Is that right?

Gregory Goff - *Tesoro Corp - Pres, CEO*

No. We have other turnaround activity in California later in.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Okay. Great stuff. We'll deal with that as it comes. And the final one is really related to your retail strategy. Obviously, you've announced some additional acquisitions this morning. What -- how do you see the running room to continue to basically add and expand? Is there kind of a level of integration that you're targeting, that ultimately you would want to move towards? And I leave it at that. Thanks.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Let me just clarify, Doug, the only thing we commented on this morning is that the transaction with SUPERVALU that we announced last year closed. And we have done the transition to our brand in that, in the month of January. So there's no new acquisition there, just a formal closing of the deal, and then integrating it into our system, which happened during the month of January. The second thing that we announced last year was a opportunity primarily in Southern California, where we would take on additional stations that we will actually start in April of this year, and do 175 stations this year, and more later. And that -- those stations give us a somewhere between 25,000 to 30,000 barrels a day of additional demand. So specifically about our strategy, we're really driving like we said to create a higher level of integration between refining and marketing. And it's done by each of the markets, we have specific targets and each in the markets, but ideally as a Company we would like to have a total gasoline integration somewhere in the low 80%, between 82% to 85% integration for the total system. We believe that gives us the best value, and our strategy is really to look at creating opportunities with wholesale customers in that. And it is not a capital intensive strategy, but if we need to invest, to acquire certain customers in that, we will look at doing that.

Doug Leggate - *BofA Merrill Lynch - Analyst*

That's terrific color, Greg. Thanks very much indeed.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Thank you, Doug.

Operator

Your next question comes from the line of Evan Calio with Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

Yes, good morning, everybody.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Morning, Evan.

Evan Calio - *Morgan Stanley - Analyst*

Can you give me a better picture of crude pricing on the West Coast? I know ANS is currently at a premium to LS. And I'm curious of your views of the driver there, and are you seeing that type of strength across all crude alternatives? Or is ANS, as has been sometimes in the past a bit more of an anomaly?

Dan Romasko - *Tesoro Corp - EVP, Operations*

Sure, Evan, this is Dan. I'll take a shot at that. ANS is a bit out of the market. It looks like to us, commanding a premium -- of course the problem with ANS, is it's just not that liquid. But it nevertheless it represents a large percentage of the crude that's run on the West Coast. So that's, I think, harkening back to one of the questions we had earlier in the car -- call, that's one of the reasons why we've got a strong foreign crude sourcing strategy for the West Coast. California domestic crudes have actually come back in line with more typical spreads, now in the \$7.00 discount to Brent. So I think domestic -- domestically, the crudes are lined up correctly, and the foreign crudes are still profitable and attractive.

Evan Calio - *Morgan Stanley - Analyst*

Okay. It (inaudible) -- a related question, I guess, on your Anacortes rail project, I mean, clearly great economic signals here versus the West Coast, and we're pretty bullish on those differentials. On a go forward basis, what is the limiting factor on 30,000 barrels a day facility, if you wanted to upsize it? Are there any elements of that chain that are oversized? And or is there any -- as well, a higher range, if once up and running, you were able to kind of move more efficiently through that loading, transloading, unloading rail facility?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Sure. The physical limitations are -- can handle significantly greater than 30,000 barrels a day. I don't think we will know for sure what those limitations are, until we actually go into operation, but the loading and offloading facilities are sized to do quite a bit more. We will need to address the permit issues, as we start to go greater than 30,000 barrels a day, should we choose to do so.



Evan Calio - Morgan Stanley - Analyst

Okay. And what's -- is that a long time line through the permitting track? And what's that, start to finish?

Gregory Goff - Tesoro Corp - Pres, CEO

When we began the permitting process, for the offloading facility itself, that took as close to five to six months I believe if -- don't hold me to that, but it was that order of magnitude. So it really depends upon the emission impacts, and public sentiment and stakeholders sentiment, should we choose to expand that facility. Just as a reminder, the loading facility has capability to go above 30,000 barrels a day as is, 40,000 barrels a day most certainly, and greater should we choose to do it. So the incremental volume does not have to go through Anacortes. It can go into the commercial market, and we intend to do so.

Evan Calio - Morgan Stanley - Analyst

That's great. Then me try a question on Hawaii. It's more of -- maybe the other side of Doug's question. I mean, are there any restrictions that you're aware of kind of anti-trust issues or regulators voiced any disapproval, with potentially Chevron as the buyer of that asset, given that they're the operator of the only 1 of 2 assets refining assets in Hawaii? Or is there a broader definition of what that market is, because it can go, maybe import or something?

Gregory Goff - Tesoro Corp - Pres, CEO

Yes. But I -- the answer is, we don't know how the regulators would view that until -- if someone chose to do what you just said, they would have to go through that process to determine that we have -- we just don't have any idea how that would turn out like that. So sorry, just can't answer it.

Evan Calio - Morgan Stanley - Analyst

Okay, and that's fair. On, I guess lastly, on Mandan, and maybe you could refresh me, but what -- is there a turnaround associated with your -- with the 2Q tie-in? And just could you kind of quantify that for me, with regard to the expansion?

Gregory Goff - Tesoro Corp - Pres, CEO

Yes. We'll go ahead and respond to that, this time. There is a -- circuit two week shutdown that occurs for the tie-in work, the capacity which is made up relatively promptly, because the expansion is 10,000 barrels a day.

Evan Calio - Morgan Stanley - Analyst

Great.

Gregory Goff - Tesoro Corp - Pres, CEO

And occurring late in the second quarter.

Evan Calio - Morgan Stanley - Analyst

Appreciate it. Thanks for the -- thanks.



Gregory Goff - *Tesoro Corp - Pres, CEO*

Thanks, Evan.

Operator

Your next question comes from the line of Paul Sankey of Deutsche Bank.

Paul Sankey - *Deutsche Bank - Analyst*

Hi, good morning.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Good morning, Paul.

Paul Sankey - *Deutsche Bank - Analyst*

Greg, I don't think these numbers have changed particularly, but I wondered if you could just remind us of your CapEx plans for 2012 and 2013? I'm -- what I'm really trying to get at, just as a reminder of how much is maintenance capital, how much is expansion capital, and within that, you previously had a number that was a discretionary amount of that could be reduced, I think relatively, quickly. So what I am really driving at, is if this kind of result was to continue how -- the sensitivities, if you want, on your CapEx for those two years? Thanks a lot.

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes, in 2012, as we said earlier, the total capital spend -- I am not talking about turnaround now -- just total capital spend in 2012 is the \$670 million. And of that \$670 million in 2012, \$375 million of that is for income projects. And as you recall, Paul, we kind of break income capital project into two buckets really, the small projects, the circa \$1 million to \$2 billion projects, and then the other projects that we have been talking about this point, like at Mandan, Los Angeles and that.

Paul Sankey - *Deutsche Bank - Analyst*

Yes.

Gregory Goff - *Tesoro Corp - Pres, CEO*

So that is -- that's 2012. In 2013, the numbers start to decline, so the total capital spend for 2013 drops by about \$130 million down to around \$540 million. But the amount of the income portion of that, stays at a pretty comparable to -- a little bit less -- but around \$300 million of income projects. And that's primarily because of the Salt Lake project which is, if you look at the timing of the projects that we've talked about when they come on line and that, the one that has one, it's more significant capital spend and longer time, is the Salt Lake project that goes into 2013.

Paul Sankey - *Deutsche Bank - Analyst*

Yes. And so -- then just remind me of the small projects, out of the 375 this year. I'm sure these are very similar, just to reiterate -- to the numbers you gave in December, I assume they are?



Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. Yes, nothing has changed. You're right, Paul, nothing's changed. Of the, for example, of the \$375 million that we'll spend on income producing capital this year, \$200 million of it is attributable to the bigger projects. And right now we have targeted \$175 million at the small capital projects, and those small capital projects include refining, marketing and transportation, just to be clear also.

Paul Sankey - *Deutsche Bank - Analyst*

And then in '13 the same break? And then can you just talk a little bit, Greg, and I'll leave it at that point, about the discretion on the small -- I think you could almost shut it down to zero if you need to, isn't that correct?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Well, let me -- the first part of your question, 2013, the small projects, you're right. They are comparable to the spend in '12, so about \$175 million in both years. And you're also right, I mean, there is a lot of work, even though they are small projects, there is still the necessary engineering work and execution to put them in. But we have a lot of discretion of how we do those things. I mean, we're driven to the because there is such attractive returns, and they're part of our efforts to fundamentally increase of performance of the business. But we do have discretion on the timing of those. That's right.

Paul Sankey - *Deutsche Bank - Analyst*

Great. Thanks, sorry to kind of make you repeat what you outlined, but I just -- just an update. Gasoline demand is -- I mean we've kind of danced around us a little bit this morning, that gasoline demand is extremely weak, margins are very, very good for this time of year. What your perspective of what's driving that?

Gregory Goff - *Tesoro Corp - Pres, CEO*

It's a good question, Paul, because if you listened to what we just said, if you take the fourth quarter -- and then Dan talked about the first -- well, the first month of this quarter of this year, our numbers for like same-store sales aren't showing the same, that the industry is saying. And I think -- I didn't pick up all the other companies that have released their earnings and that, but I think in some cases, they weren't saying -- seeing the same type of demand, the impact on demand that's coming out with the numbers. So I'm not sure that we have a good explanation on what's going down from a pure demand standpoint, if -- I don't know. We don't have a good explanation. We just know what's happening in our -- in our facilities.

Paul Sankey - *Deutsche Bank - Analyst*

And what you're saying, is that your sales are not matching what the DOE is saying basically?

Gregory Goff - *Tesoro Corp - Pres, CEO*

That's exactly what we're saying.

Paul Sankey - *Deutsche Bank - Analyst*

Great. Thank you, Greg.



Dan Romasko - *Tesoro Corp - EVP, Operations*

Thanks a lot.

Operator

Your next question comes from a follow-up from Paul Cheng of Barclays.

Paul Cheng - *Barclays Capital - Analyst*

Hi. Just a quick question. The number of bonds share item. Scott, do you have -- what is your market value of inventory in excess of [book], your long-term debt component of total debt, and that, how much of that debt also belongs to the Tesoro Logistics? And then finally, Greg, can you give us an update at whether the Tesoro construction has stopped, and that where we are over there?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Yes, Paul, the market value of our -- the excess market value over book of our inventory is \$1.7 billion. Current portions of our -- or the current maturities on our debt is \$400 million. And that does not include anything for TLLP. We've got \$50 million drawn on the TLLP revolver, but that revolver expires beyond one year, so there is no current maturities from that.

Paul Cheng - *Barclays Capital - Analyst*

Right. So Scott, that means that your long-term values, \$1.3 billion, right? Of the \$1.3 billion, is there any -- how much of them, that maybe is in the TLLP? And also if you can give me the working capital?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Okay. There is 50 -- to answer your question, of debt related to TLLP, and working capital excluding cash at the end of the quarter was \$420 million --

Gregory Goff - *Tesoro Corp - Pres, CEO*

Not at TLLP --

Scott Spendlove - *Tesoro Corp - SVP, CFO*

No, not at TLLP -- (Multiple Speakers).

Gregory Goff - *Tesoro Corp - Pres, CEO*

There is no working capital --

Scott Spendlove - *Tesoro Corp - SVP, CFO*

I'm sorry, Paul, were you asking about working capital at TLLP or Company?

Paul Cheng - *Barclays Capital - Analyst*

I'm talking about working capital for the Tesoro Corporation, and then if there's any of them related to TLLP also.

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Right, yes, working capital, excluding cash for the Corporation is \$420 million, and there's no working capital associated with TLLP.

Paul Cheng - *Barclays Capital - Analyst*

Okay.

Gregory Goff - *Tesoro Corp - Pres, CEO*

And then, Paul, on your question regarding Salt Lake, let me let Dan respond to your question about where we stand in that project.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Okay, Paul. Yes, Lake City is still in the permitting process. As you recall at Analyst Day, we rolled that project out or shortly before it, and when we rolled it out, we announced some really great news with that project, and that is, that we had an agreement with Newfield. That agreement with Newfield, as our crude supplier brings in a different crude mix than we originally had thought we were going to have, when we began the product work early in last year. Which, in the end, turned out to be quite good news, because it made the project larger and increased the EBITDA stream. Long story short, we're still in engineering, on the project and permitting phase.

Paul Cheng - *Barclays Capital - Analyst*

When do you may start the actual construction? Any expectation?

Dan Romasko - *Tesoro Corp - EVP, Operations*

I think it probably would be best to discuss, when we've targeted those phases of operations to be complete. And our expectation on that is mid 2013, and then mid to late 2014 for phase 1 and phase 2.

Paul Cheng - *Barclays Capital - Analyst*

Okay. Very good. Thank you.

Operator

Your next question comes from a follow-up from Chi Chow of Macquarie Research.

Chi Chow - *Macquarie Research - Analyst*

Thanks. Greg, there was a ruling in California against the state's low carbon fuel spec regulation. How does this impact your thinking on the regulatory environment out there? And it does the ruling in your mind, improve the long-term cost of compliance and doing business there at all?



Gregory Goff - *Tesoro Corp - Pres, CEO*

Go ahead, Dan.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, sure. This is Dan. I'll take a shot at that. That ruling clearly challenged the constitutionality of the low carbon fuel standard. And to the extent that it's upheld, then we certainly get a period of time where there's going to be relief, on the low carbon fuel standard. If I were to summarize where we are in California, regarding AB 32 and the low carbon fuel standard, it would be, that it has been, is, and will continue to be a bit of an unknown commodity. It doesn't materially impact the direction that we are taking in 2012. The impacts of the low carbon fuel standard, both on a stationary source perspective, and on carbon intensity and fuels, was relatively benign for 2012 and 2013.

Chi Chow - *Macquarie Research - Analyst*

Does it give you any comfort on lower compliance issues going forward, 2015 onwards, or whenever it really hits?

Dan Romasko - *Tesoro Corp - EVP, Operations*

It -- we certainly believe that it has the potential to delay the implementation, and potentially significantly. But we honestly don't know where the court battle's going to land.

Chi Chow - *Macquarie Research - Analyst*

Okay, thanks. And one final thing, are there any issues -- are you all clear of the labor issues with the steelworkers at this point?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Yes. We are -- what you've seen in the news, I mean, we now need to go into each of the locally local bargaining units, and process that through with the bargaining units, which we are, -- which we've begun to do. So we expect that to move that through that process over the next few weeks here.

Chi Chow - *Macquarie Research - Analyst*

Are you anticipating any issues at the local level?

Gregory Goff - *Tesoro Corp - Pres, CEO*

Not at this time. We just need to work through with the bargaining units to get resolution.

Chi Chow - *Macquarie Research - Analyst*

Okay. Great. Thanks, Greg.



Gregory Goff - *Tesoro Corp - Pres, CEO*

We appreciate everyone's time this morning. Thank you for the questions, and I look forward to talking to you again.

Operator

Ladies and gentlemen, that concludes the Q&A session. That concludes the presentation as well. Enjoy the remainder of your day, and have a great day. You may now disconnect.

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