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TSO - Q2 2016 Tesoro Corp Earnings Call

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OVERVIEW:

Co. reported 2Q16 net earnings from continuing operations attributable to Co. of \$418m or \$3.47 per diluted share.



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PRESENTATION

Operator

Welcome to your Tesoro Corporation second quarter 2016 earnings conference.

(Operator Instructions)

As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Sam Ramraj, Vice President of Investor Relations. Please go ahead.

Sam Ramraj - Tesoro Corporation - VP of IR

Good morning. Welcome to today's conference call to discuss the second quarter 2016 earnings. Joining me are Greg Goff, Chairman and CEO; and Steven Sterin, Executive Vice President and CFO.

The earnings release, which includes financial disclosure and reconciliations for non-GAAP and financial measures, should help you in analyzing our results and can be found on our website at tsocorp.com.

I would like to point out that starting this quarter, Tesoro will no longer be reporting our adjusted EBITDA and adjusted EPS but will continue to highlight significant items impacting quarterly results to help you analyze our performance. Further information can be found in the earnings release issued yesterday.



Please refer to the forward-looking statement in the earnings release which says statements made during this call that reference the management's expectations and our future predictions are forward-looking statements intended to be covered by the Safe Harbor provisions of the Securities Act as of the many factors which could cause results to differ from our expectations. Now, I'll turn the call over to Steven.

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Thank you, Sam. Good morning. And thank you for joining us today. I'll review our second-quarter 2016 financial performance and then turn the call over to Greg.

Yesterday, we reported second quarter 2016 net earnings from continuing operations of \$418 million, attributable to Tesoro, or \$3.47 per diluted share compared to \$586 million, or \$4.62 a share a year ago. Consolidated net earnings were \$449 million for the second quarter, compared to \$620 million for the same period last year and EBITDA for the second quarter was \$956 million, compared to \$1.2 billion a year ago.

Reported earnings and EBITDA for the quarter included a pre-tax inventory benefit due to a lower cost of market valuation adjustment of \$363 million, or \$220 million after-tax. Our second-quarter 2016 results reflect continued growth in the Logistics business and strong performance in marketing, offset by lower-than-expected performance in refining.

Turning to the business segments. Refining operating income was \$520 million for the second quarter compared to \$757 million a year ago and segment EBITDA was \$692 million versus \$880 million last year. The Tesoro Index was \$13.93 a barrel in the second quarter, with a gross refining margin of \$15.70 a barrel or 113% of the Tesoro Index.

This compares to gross refining margin of \$19.13 per barrel, or 89% of the Tesoro Index last year. Please remember that gross refining margin in the quarter included a pre-tax benefit of \$363 million related to the LCM inventory adjustment.

Total refining throughput for the quarter was at the lower end of our guidance at 802,000 barrels a day, or 92% utilization. During the quarter, we had an extension of the planned maintenance at our Kenai, Alaska refinery as well as unplanned unit downtime within our California region, and both of these impacted our throughput and capture rates.

Manufacturing costs in the second quarter decreased \$0.57 a barrel over the same period last year to \$5.01. This year-over-year decrease was due to the higher throughput in 2016 compared to 2015, but also in decline in natural gas prices. Tesoro's integrated business model helps mitigate our exposure to RINs; however the price of RINs increased in the second quarter, and impacted us by approximately \$10 million.

Moving to Logistics. Operating income increased to \$125 million in the second quarter from \$104 million a year ago and segment EBITDA grew to \$172 million from \$149 million last year. Results benefited from year-over-year volume growth in a crude oil gathering, terminalling and transportation businesses as well as contributions from TLLP's acquisition of the LA Storage and Handling Assets.

The total general partner and limited partner distributions received by Tesoro were \$59 million during the second quarter. This is an increase of \$26 million or 79% versus 2015.

Turning to marketing, operating income was \$161 million compared to \$212 million a year ago and segment EBITDA was \$173 million compared to \$223 million last year. Our fuel margins were \$0.105 cents a gallon in the second quarter. During the second quarter, we saw continued strong fundamentals and favorable business conditions. These include growth in consumer demand, increasing vehicle miles traveled, growth in Tesoro's fuel-cell volumes of 6%, and 8% increase in the total number of stations in our network and marketing integration increased to 98% from 93% a year ago.

Now I'd like to take a moment to discuss our continued focus on creating value for shareholders by driving improvements in our business. Then I'll discuss our financial discipline and principles of capital allocation. We remain committed to driving improvements in the earnings of our business each year and in all cycles of the industry.



In 2016, we committed to delivering \$400 million to \$500 million of operating income in EBITDA improvements through these efforts. This includes organic growth and acquisitions in our Logistics business, growth in our marketing business, and cost, yields, and other efficiencies in refining and commercial operations.

We're on track to deliver these results in 2016. These improvements can be seen in our relative performance over time; in fact, if you look at Tesoro's earnings CAGR since 2014 versus that of our core peers, you'll see our overall earnings are down approximately 4% due to lower overall refining industry margins in crude differentials.

However the core peer group is down 15% to 25%. We believe this reflects the impact of our continued focus on driving business improvements every year. Further, the same relative outperformance can be seen in our free cash flow yields. This continued focus on and execution of driving improvements results in significant shareholder value creation and that continues to be seen in our cash flows and capital allocation priorities.

We ended the quarter with a consolidated cash balance of \$1.1 billion compared to \$942 million at the end of 2015. Our balance sheet remains strong with a total debt net of unamortized issuance costs to capitalization ratio of 36%. Excluding TLLP debt and equity, our debt to capitalization ratio is 19% at the end of the second quarter.

We also currently have \$2.1 billion of availability under our revolving credit facility. We continue to believe that we are well-positioned to obtain investment grade ratings for both companies. Investment grade credit ratings for Tesoro and TLLP offer substantial benefits to both companies including lower relative debt spreads of 100 to 200 basis points over time; potential combined interest cost savings of \$80 million to \$105 million; and most importantly, the ability to access extended debt maturities for TLLP.

Turning to cash flows, Tesoro generated \$444 million of cash flow from operating activities in the second quarter. Let's now discuss how we deploy cash to create long-term shareholder value. First, we invest in high-return capital projects and grow returns on invested capital.

During the quarter, we invested \$105 million in income growth per capital projects at Tesoro and TLLP. Our combined capital expenditures through the first half of 2016 were approximately \$400 million. We expect 2016 capital spending of approximately \$1 billion, which is consistent with our previously announced plan.

Second, we continue to ensure we have a strong balance sheet to give us the flexibility to make strategic investments and return cash to shareholders. In the quarter, we spent approximately \$80 million in two highly accretive acquisitions. We continue to look for additional opportunities and are currently focusing on targets in midstream and other assets which can enhance our integrated business model.

During the second quarter, we repurchased 1.3 million shares for approximately \$100 million. Tesoro currently has \$1.3 billion remaining under its previously approved share repurchase program. We also paid quarterly dividends of \$121 million and distributed \$98 million to noncontrolling interests.

Yesterday, we announced that our Board approved 10% increase to the quarterly dividend, which is now \$0.55 a share or \$2.20 per share annually. Additionally, during the quarter, TLLP successfully raise approximately \$1 billion of debt and equity. TLLP repaid the amounts outstanding under its revolving credit facility and will use the balance to fund future drops and growth investments.

As we enter 2016, given the uncertainty in MLP capital markets, Tesoro plans to support TLLP's growth and takes approximately 50% of dropdown proceeds in the form of TLLP units. Given the success and the strength of TLLP's equity and debt offerings in the second quarter, Tesoro now has the flexibility to receive a greater portion of cash as consideration for future dropdowns.

With July's Alaska Storage and Terminalling Assets dropdown in the newly announced Martinez Storage and Marine Assets dropdown. TLLP now expects probably \$50 million to \$75 million of net earnings or approximately \$90 million to \$110 million of annual EBITDA from dropdowns from Tesoro in 2016, which is an increase of approximately 10% to 30% from previous guidance.



This increased EBITDA range for TLLP provides Tesoro the opportunity to obtain higher-than-previously-expected cash proceeds from dropdowns in 2016. Looking ahead, you can find details of our planned throughput, manufacturing cost per barrel and other elements related to our second-quarter outlook in our earnings release issued yesterday. With that, I'll turn the call over to Greg.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Thank you, Steven, and good morning. Tesoro's integrated business model enabled us to execute well this quarter. Even with a Tesoro Index 6% lower compared to the average of 2014 and 2015, we completed two acquisitions that further strengthened our portfolio and each has significant synergy opportunities and growth potential.

Turning to refining operations, on the West Coast, we saw increased product demand in the quarter. Our refining utilization in California was 94% ; throughput and capture rates were impacted by unplanned unit downtime in the region. In the Pacific Northwest, our performance was impacted by longer-than-planned maintenance in our Kenai Alaska, refinery and this led to lower throughput in the region.

In the Mid-Continent, the Tesoro Index was down approximately 34% in the second quarter to \$14.65. This lower margin environment, along with narrower crude oil differentials, negatively impacted year-over-year operating results. For the third quarter, we expect overall refinery utilization to be between 93% and 99%.

Moving to Logistics, Tesoro Logistics delivered strong operating income and segment EBITDA growth in the quarter, despite the continued weak overall commodity environment. TLLP's performance in the quarter was driven by growth in our crude oil pipeline gathering, natural gas liquids processing, terminalling and pipeline transportation throughput as well as contributions from the Los Angeles Storage and Handling Asset acquisition.

Year to date, TLLP has seen volume growth of approximately 23% in crude oil pipeline gathering volumes, 5% in NGL processing throughput, 4% in terminalling throughput, and 4% in pipeline transportation volumes over the same period last year. Additionally, on July 1, Tesoro agreed to sell storage and terminalling asset in Alaska to TLLP for \$444 million. These assets include crude oil, feedstock and refined product storage tanks in Kenai, Alaska and refined product terminals in Anchorage and Fairbanks.

The total acquisition price includes cash proceeds to Tesoro of \$400 million in the issuance of common and general partner units to Tesoro, valued at about \$44 million. Tesoro expects to offer TLLP the opportunity to acquire crude oil and refined product storage and marine assets in Martinez, California in the second half of this year.

These assets could add \$16 million to \$36 million of annual net earnings and \$40 million to \$60 million of annual EBITDA to TLLP. Also, Tesoro now expects to offer the previously announced Great Northern Midstream Assets in North Dakota for sale to TLLP sometime after this year. Looking forward, TLLP continues to grow its business and remains on track to achieve our target of \$825 million of annual operating income and \$1 billion in annual segment EBITDA by year end of next year.

Shifting to our marketing business, overall performance in the quarter was good. During the second quarter, we saw continuing positive trends in the market and in our business.

Continued strong consumer demand, with gasoline demand up 2.5% through May, an increase in vehicle miles traveled of 3.4% through the same time period, growth in Tesoro's fuel volumes of about 6%, an increase-- 8% increase in the total number of stations in our network and marketing integration, as Steven said, increased to 98% versus 93% last year.

We remain excited about the growth prospects we see in this business against the backdrop of a strong economy, growth in consumer demand and favorable conditions in the markets in which we operate. We continued to expand our network of stations and focus on growth opportunities towards our goal of \$960 million of operating income and \$1 billion of segment EBITDA by 2018.



Turning to strategic acquisitions and project updates, we closed the acquisition of wholesale marketing and Logistics assets in Anchorage and Fairbanks Alaska in June. The acquisition enhances our capability to efficiently and reliably serve our customers in the state of Alaska. In addition, as I referenced earlier, we agreed to sell the Logistics portion of this acquisition to TLLP in July. We also acquired the Dakota Prairie Refinery, a 20,000 barrel a day refinery in Dickinson, North Dakota and its associated business.

A brief update on the Vancouver Energy Project, the Washington State's Energy Facility Site Evaluation Council, or EFSEC, concluded the five-week hearing portion of the adjudicative phase on July 29 of this year on -- once EFSEC issues a final environmental impact statement, they will provide a recommendation to the Governor of Washington.

We are very committed to the proposed 360,000 barrel per day crude oil rail-to-marine terminal and remain confident that a thorough evaluation will clearly demonstrate that we can design, construct and operate a safe, environmentally responsible facility that offers benefits to the State of Washington and the West Coast.

Moving to the Los Angeles Refinery Integration and Compliance Project, we continue to make progress on the permitting process. The public comment period closed in mid-June and the South Coast Air Quality Management District is currently responding to the comments that were submitted and preparing the final environmental impact report.

We continue to expect to have the necessary permits and approvals by the end of this year and plan to begin construction thereafter. As you know, we are excited about this project because it enhances our position on the West Coast and offers several benefits, including the full integration of the Carson and Wilmington operations, yield flexibility of 30,000 to 40,000 barrels per day between gasoline and distillates, and a significant reduction in greenhouse gas and other criteria pollutant emissions.

To provide you an update on the progress to deliver improvements in our business, at our Investor and Analyst Day last December, we laid out our expectations for 2016 which were based upon a Tesoro Index of \$12 to \$14 per barrel, marketing fuel margins of \$0.11 to \$0.14 per gallon, crude oil differentials that reflect the cost of transportation, and year-over-year improvements from higher utilization and operational efficiencies of \$500 million to \$600 million.

Through the first half of the year the Tesoro Index and marketing fuel margins are basically in line with our expectations. Crude oil differentials, however, continue to be significantly narrower than our expectations. This has resulted in lower capture rates and lower refining profitability than our original expectations for this year.

Refining utilization is at the low-end of our expectations, primarily due to unplanned maintenance. As a result, we now expect year-over-year improvements from higher utilization and operational efficiency of \$400 to \$500 million. Additionally, we committed to delivering \$400 million to \$500 million of annual improvements to operating income in consisting of \$200 million to \$250 million in refining, \$175 million to \$200 million in Logistics, and \$25 million to \$50 million in marketing.

As Steven said, through the first half of 2016, our estimated refining and marketing improvements on track with our full-year expectations. The Logistics improvements are tracking slightly below the range, which is primarily attributable to slower-than-expected organic growth due to the weak commodity price environment.

For the full-year 2016, we remain committed to delivering the \$400 to \$500 million of annual improvements to operating income we laid out at our Analyst and Investor Day. Let me conclude by saying that we are committed to creating shareholder value by continuing to optimize our assets across the [in] value chain, driving improvements in the business, and growing and transforming our portfolio of refining Logistics and marketing assets. Now, we will take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you.

(Operator Instructions)

Jeff Dietert of Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

Yes. It's Jeff Dietert with Simmons.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Good morning, Jeff Dietert.

Jeff Dietert - *Simmons & Company International - Analyst*

Good morning. ((laughter)) You've announced or agreed on the Alaska Storage and Terminalling sell down to TLLP and with today's announcement, the Martinez Assets and these are drawing bigger cash portions than you previously discussed. You add lower CapEx that you announced in the first quarter call and throughput guidance that looks healthy for 3Q, no sign of major maintenance.

It looks like there is a pretty meaningful step-function increase in cash in the back half of the year. Am I interpreting that correctly? Could you discuss that a little bit?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, you're exactly right Jeff. If you take everything that you just talked about and our starting point from what Steven just mentioned that we ended the quarter with a \$1.1 billion cash balance. And you add up our -- the factors.

I won't even elaborate on those, what you've stated, it would suggest that our cash balance would be significantly higher at the end of the year, particularly versus what we laid out with our plans. I think the important point is and I don't probably need to reiterate but Steven laid out our allocation of capital and that's basically unchanged as we move forward.

Jeff Dietert - *Simmons & Company International - Analyst*

And it appears that this -- it looks like a step-up in dropdowns in the TLLP but again, it's allowing you to meet your targets that you discussed last December; is this really in line with your expectations or is there some acceleration there?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

What happened is that we originally intended, as we stated, to have two asset sales from Tesoro to Tesoro Logistics in 2016. The first one was the Alaska, which we complete -- started at the beginning in July. The second one originally was anticipated to be the, what we refer to as the great Northern Pipeline System in North Dakota, which was the acquisition that Tesoro made in January of this year.



But as we got into that business more and we looked at how we wanted to commercialize those assets, we always recognized when we made the acquisition that we wanted to make some changes that would provide the service and the cost effectiveness to the producers and that's just taking us a little bit longer than we anticipated.

We had hoped to be able to complete it for the second half of 2016. That's going to be a little bit slower so we'll move that forward and we were prepared already to do the drop we're doing at Martinez in the first half of 2017 so we effectively just flipped the two transactions. So fundamentally, there's really no change.

Jeff Dietert - *Simmons & Company International - Analyst*

Got you and could you talk about the considerations as to how the Martinez Asset drop might be financed? What percentage might be cash?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, let me -- Steven is the expert on that. Let me ask him to comment.

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Hey Jeff. When we came into the year, if you look prior to 2016, we typically -- and one of the reasons we have an MLP, when we do drops, is to bring back substantial cash to Tesoro for further value creation. That's good for TLLP but it's also very, very good for Tesoro and heading into this year, there was tremendous uncertainty, if you recall in the first quarter around the capital markets in the MLP space.

And our base plan was to only get about 50% cash from those drops. You can see in the first drop that we just announced and Greg highlighted this morning that we got 90% cash. I have no reason to expect at this point that we won't see substantially higher than 50% cash in the next drop as well.

Jeff Dietert - *Simmons & Company International - Analyst*

Thanks for your comments.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Thanks Jeff.

Operator

Neil Mehta of Goldman Sachs.

Neil Mehta - *Goldman Sachs - Analyst*

Good morning, guys.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Hey Neil.

Neil Mehta - *Goldman Sachs - Analyst*

So Greg, I want to talk a little bit about the West Coast here. I'm just looking at the Tesoro Index on your website, it looks like in July, it's fallen from \$15.50 to \$11 a barrel. As you think about the California market, what do you think is putting pressure on it during the summer driving season? Is it a function of imports from Asia? Is it the restart of Torrance? Is it a combination of a couple different things and what's the mechanism you see that clearest this up?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, I think Neil, the short-term observation that you just made for the month of July is kind of right on because that's what we have on our website, as you've stated. So I think it's more important to take a step back and look at the fundamental drivers in the West Coast region of the United States, and from everything that we've been both observing and saying over the last couple two or three years, you see continued strong demand growth.

The refineries have been running in the utilization rates that they typically have because the market has been in a position where to supply the product and the -- with the demand and overall fundamentals, we see the market as being very, very attractive from a fundamental analysis standpoint.

However, today we find ourselves in a period of time where the market is a lot weaker and you probably hit the nail on the head with the two points that you made. You had -- did experience a little bit higher levels of imports during the transition of ownership in our refinery in California and that change in ownership is working its way through the system.

But as we look forward, the fundamentals to us are as attractive as they've ever been so we don't see anything that would indicate to us that there is any structural change in the market that would have an impact on the margin environment going forward.

Neil Mehta - *Goldman Sachs - Analyst*

Do you think the margin as it stands right now, Greg, is enough to close the import from Asia and therefore, back out the imports?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, I mean you don't -- you actually don't need the product to get into there -- to the market right now. It's a -- the market is well supplied and so we don't see the imports coming forward into the market, Neil.

Neil Mehta - *Goldman Sachs - Analyst*

Great. And then the follow-up question here is on retail going back to your retail indicators here, July has been outstanding. And so can you talk a little bit about the margin environment and why you're seeing that strength? Is it just a reflection of demand or something else? And then as we look at your stock, there's an argument that you're not getting a lot of credit for that marketing or retail business. What's the path to unlocking that value?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, so I -- you use the right word to describe the market environment, so I don't -- for retail. I mean, it's very good right now. It's been -- it -- actually in the second quarter was a little bit -- it was a relatively stable market environment in that and as a result, our margins were a little bit on the lower end of what we would have expected in that.

But demand was good and the supply to customers worked extremely well and the same dynamics, we believe, are in place that we've had for some time so we see a very good outlook for the supply to the customers in the third quarter.

The -- your second question about the -- how our shares show up in the marketplace. I think just probably three or four key comments. One is, you know and everyone else knows, we are absolutely committed to continue to drive improvements in the business, which we've demonstrated to be very good at being able to deliver those improvements.

And as both Steven and I stated, we are on track to accomplish what we laid out for this year and we'll lay out our plans for next year at the end of this year so I think that's important. The -- in the -- from a refining standpoint, we are absolutely committed to driving a very strong operating excellence management system, which translates into high reliability in our refining operations.

The second quarter was not good for us. We experienced some unplanned maintenance that we didn't expect to have and we've dealt with that. It's all been taken care of and we are running extremely well right now so that was a little bit disappointing but it's that focus on driving of continued operating excellence in our operations.

We want to be able to continue to grow both the Logistics business and we are encouraged by what we see out there and the things that we're working on as well as the marketing business. We're in the early stages of our plans that we talked about last year on marketing.

We -- Steven mentioned that a number of our station count is up about 8% year on year, which is strong growth primarily in what people refer to as the wholesale, or the jobber channel. And we continue to drive fundamental improvements in the marketing business. So we are going to stay absolutely focused on those commitments that we've made to driving improvements in the business. And we believe that the market will see the impact of that as we move forward over time.

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Neil, it's Steven. One thing also, I think if you look back earlier in the year, the value of Refiners Logistics Assets and the ability to generate cash from those assets versus either being a decline in the rate of growth or the inability to access the capital markets. I think that's something that we continue to demonstrate the strength of TLLP on a relative basis and so I think that, that's one element of what we've been doing as well, to your earlier point, may not be recognized.

Neil Mehta - *Goldman Sachs - Analyst*

Appreciate it. Thanks guys.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Thank you Neil.

Operator

Roger Read.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Good morning.



Greg Goff - *Tesoro Corporation - Chairman & CEO*

Hi, Roger.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

I guess, Greg, maybe a follow-up on some of the comments there on the West Coast gasoline market. When you've talked before -- or if you look back several years ago, the thought was always that if California refineries or West Coast refineries ran full out, the market was a little oversupplied. One goes down, market gets great.

You made the comment that we don't need any extra product right now and it seems to me that most of the West Coast is running fairly well. Have there been any changes in the way you're looking at that? Has demand been a little bit weaker or it's just a function of the imports that came in earlier? I'm just trying to get a feeling of that fundamental shift underway in the West Coast of almost permanent undersupply or exactly what we're looking at?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, Roger, probably nothing further to add. When you do just a pure fundamental analysis of the West Coast market, our indications are when refineries run at relatively high utilization rates, that the gasoline market needs a small amount of imports to meet the needs of the marketplace and that analysis hasn't changed.

So we see good demand still. We see refineries running at the higher end of the utilization versus historical levels but all -- in the inventory levels are at a comfortable level. They are kind of where they are on a five-year average standpoint, so all of those factors look good. We do not see anything that would give any indication, other than what we've already said, really.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay. And following up on that, the retail demand obviously looks good. If you look out to next year and we have another 1% or so net growth and fuel demand, I mean that would imply that California is going to ultimately need a slightly higher level of imports or a much better utilization across the whole platform, right?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, no, you're exactly right. The only thing I think you need to factor in when you look out, as you know, is you need to look at what the maintenance plans are for the entire refining system and how that would impact the supply/demand balance. So it could require a little bit more product, depending upon the level of maintenance activity on a relative basis but it would require more imports.

Roger Read - *Wells Fargo Securities, LLC - Analyst*

Okay. Great. And then just a last question, the permit process for the California integration or the Southern California integration, are there any particular hurdles we should be watching for here, a particular date of what would occur or anything like that?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

There is no -- the actual hearing process that culminated probably five or six weeks ago, all of that is in the hands of the South Coast Air Quality Management District. We believe we're in the window for the permit to be granted here and as I stated, we are on track to start construction as soon as we receive the permit so we're just going through that final stages of the process, really.



Roger Read - Wells Fargo Securities, LLC - Analyst

Okay. Thank you.

Greg Goff - Tesoro Corporation - Chairman & CEO

Thank you.

Operator

Blake Fernandez of Howard Weil.

Blake Fernandez - Scotia Howard Weil - Analyst

Hey guys. Good morning. Hi, Greg. I wanted to tie in with Jeff's comment on the cash balance into the second half of the year and how that ties in with the buybacks. Obviously, you had a decent amount of buybacks in 2Q, but I'm just curious, should we be thinking at of a more ratable program since you have so much cash coming from the drops regardless of what the macro environment looks like? I mean, it seems like that allows you to kind of continue purchasing throughout the cycle. But I just want to confirm that, that's kind of what you're thinking.

Greg Goff - Tesoro Corporation - Chairman & CEO

Yes, let me -- I'll ask Steven to comment on that, Blake.

Steven Sterin - Tesoro Corporation - EVP & CFO

Hey Blake. Our strategy of really working to have the flexibility to either make strategic investment acquisition and return cash to shareholders throughout the cycle has really been our consistent approach and focus and that is still true today. To your point, we did do some share repurchases in the second quarter.

I wouldn't think about it as necessarily being just a ratable fixed amount but our goal is to be able to generate enough cash to allow us to fully execute our growth plan and continue to buyback shares as well as grow the dividend over time commensurate with the quality and the growth of the underlying business portfolio. And so you should expect us to continue to execute that way.

Blake Fernandez - Scotia Howard Weil - Analyst

Got it. The second question was on the recent acquisition of the Dakota Prairie Asset. For one, I see there's an uptick in the Mid-Continent throughput. I'm assuming that's function of that asset being added to the mix but more broadly speaking, could you just talk about some of the longer-term opportunities there? It seems like given the construction cost of that asset, which you actually paid for it or just basically assume debt, it seemed like a real opportunity once Bakken differentials move back in our favor.

Greg Goff - Tesoro Corporation - Chairman & CEO

Yes, Blake. I think there are three key points to make about the -- what we now refer to as the Dickinson Refinery, is that, one, because of our system approach to operating the business, we will be able to deliver probably more than what we stated earlier from the synergy impact.



If you recall our press release, we stated that we expected to deliver about \$20 million of synergies and once we got actually into the business, which I'll remind you, it's only been about 30 days, we've actually seen more opportunities in that, which is always encouraging. And so for being able to operate it in our system, it will fit in very, very well to the Tesoro total integrated value chain.

The other two points are -- is -- are that, one, we will continue to ultra-low sulfur diesel to the business market that the Dickinson refinery operates in and more encouragingly, the naphtha and the resid that comes up the refinery will fit extremely well into other refineries in Tesoro, which will be able to upgrade by running it through primarily our cat crackers.

So that's -- that will provide an added benefit versus what was done with the particularly the naphtha in the past and then the third thing is, is that we're in the early stages. We see other opportunities with the refineries since so the way that the refinery is constructed provides the potential opportunity to produce renewable diesel.

And that is something that we're in the early stages of evaluating and we would expect to have that work done by the latter part of this year and that's important because when you look at the total system and particularly in the State of California and our need for renewable diesel, the value of producing it versus purchasing it is very, very attractive.

So we are reasonably optimistic we'll be able to make that happen going forward here. So that's the value of the Dickinson Refinery to Tesoro.

Blake Fernandez - Scotia Howard Weil - Analyst

Great, thanks. And just rounding out, that is part of the throughput increase, I'm assuming in 3Q obviously, right?

Greg Goff - Tesoro Corporation - Chairman & CEO

In 3Q, yes, yes. 3Q, you are correct.

Blake Fernandez - Scotia Howard Weil - Analyst

Okay. Thanks, guys. I appreciate it.

Operator

Sam Margolin of Cowen and Company.

Sam Margolin - Cowen and Company - Analyst

Morning.

Greg Goff - Tesoro Corporation - Chairman & CEO

Hi Sam.

Sam Margolin - Cowen and Company - Analyst

First of all, thanks for the breakout of the inventory impact regionally in the press release; that's helpful. I was just looking at the California results and net of the inventory, the capture looks like it was affected by the downtime you mentioned. I was wondering if there were any other factors



in there, specifically if there's been a change to the residence -- to be segment residence of RINs in the consolidated system? If some -- if you recognized those in marketing now and transfer them back to refining or if it's the same as it has been?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

The only impact to our results for California for 2Q is a result of some unplanned maintenance that showed up in both lower throughput and the capture rate. That's it.

Sam Margolin - *Cowen and Company - Analyst*

Okay. And then just following up on the Great Northern Assets, I recall there was a -- there's a, for that transaction, there's a pretty wide arbitrage between the acquisition valuation and then what you could drop it down for. I was wondering if you're seeing anything in the landscape that's continuing that trend or if it's -- if that spread has been dynamic, given the commodity environment?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Well, let me correct what you said because that statement at the beginning is not accurate. There is no wide arbitrage. The -- what we've said about the acquisition of the Great Northern Assets was that we paid a very attractive value on a relative basis and that our intention was to then take those assets. And at the appropriate time after we -- I guess the best way to describe it is we further commercialized that system into the overall Tesoro North Dakota System, we would sell that to Tesoro Logistics but it's incorrect to state that there's some wide arbitrage ; that's not accurate.

Sam Margolin - *Cowen and Company - Analyst*

Okay. Thanks for the clarification.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

You're welcome.

Operator

Chi Chow of Tudor Pickering.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Great, thanks. Good morning.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Hi, Chi.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Hi. Greg, so with the downturn in the crude market this year, are you seeing any actions on your transportation cost coming down in your regions and specifically, is it making rail and your terminal fees on rail actually a better option at this point versus what we're seeing from last year?



Greg Goff - *Tesoro Corporation - Chairman & CEO*

Absolutely. So we have mentioned this in the past that directionally, we would see changes in the cost, the total cost structure and for Tesoro, that's moving rock and crude from North Dakota to the West Coast, as you're aware, that we would see changes and actually pretty significant changes to make the movement of rail more competitive with, for example, pipeline out of Bakken.

And that is absolutely starting to happen across all parts of that supply chain and kind of along the lines of what we thought it would be so we are very confident that when that -- all those changes work their way through, which probably isn't too far off from now, the movement of Bakken crude oil by rail to the Pacific Northwest will be very competitive with pipeline shipments out of North Dakota.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Can you quantify what target you expect on those rail costs going forward here?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

If you take what we've said historically around, specifically around moving Bakken to our Anacortes Refinery, I think in the past we talked about a number between \$9 and \$10 a barrel. We would expect those numbers to come off as much as 40%.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay. Well, that's -- will be a nice move. What level of rail volumes are you moving right now to Anacortes?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

It's unchanged from what we have. Our facility is a 50,000 barrel a day facility and for the most part, it runs at a very high utilization rate.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Okay, great. And then I also have a West Coast market question, not so much on imports coming in but on the export market. Are there strategies you are looking to grow that market for you out of California? How important is that market? It seems like Latin America, Mexico, it's been a destination even from the West Coast.

There's been some reports of Chinese barrels even showing up in Mexico these days. Just any discussion on what you're seeing in that dynamic? Any competition for that export market and what are you going to do to grow that market?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

I think if you look at the regional supply/demand and you take the West Coast at both -- starting all the way from West Coast to Canada to -- through the United States into Mexico, you will see that there's a need for imports into that greater region. And it's kind of a natural flow. It makes sense for particularly, say, the Pacific Northwest to be able to move product into Mexico.

We see about 140,000 barrel a day need for product on the West Coast of Mexico for gasoline and distillates and a natural place for that is to have this system balance across that whole Western region. So as a Company, we've stated many times in the past that it's a natural part of our system in moving product into Mexico, Chile and Peru, primarily.

And we don't see any structural changes in that. We still see, especially Mexico, to have the strong need and healthy and reasonably good demand growth and that presents opportunities to go about that business different ways that we're just in the early stages of looking at to see what makes sense for Tesoro over time and we don't have an answer on that yet.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Are you moving barrels from Anacortes into Mexico right now?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

When we most barrels from -- into South, we -- it comes from the Anacortes area.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Interesting. Okay, thanks. And one maybe final quick question for Steven. For 3Q, do you have any estimate on the working capital impact with commodity prices coming down in the quarter?

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Yes. We -- as we look at working capital internally, we continue to try to find ways to reduce our overall levels of working capital and we see opportunities to continue to do that. As you said, sometimes when commodity prices drop, you see short-term price impacts on that but overall, our intent is to continue to make working capital a source of cash over time.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

You expect that in 3Q to be a source of cash?

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Most likely. I don't -- we don't get to specific by quarter but directionally in the second half, we do expect working capital to be a source of cash.

Chi Chow - *Tudor, Pickering, Holt & Co. Securities - Analyst*

Great. Thanks Steven.

Steven Sterin - *Tesoro Corporation - EVP & CFO*

Thank you.

Operator

Ryan Todd of Deutsche Bank.

Igor Grinman - Deutsche Bank - Analyst

Good morning, guys. This is actually Igor Grinman chiming in for Ryan.

Greg Goff - Tesoro Corporation - Chairman & CEO

Hi, Igor.

Igor Grinman - Deutsche Bank - Analyst

Hi, Greg. You've spoken a decent amount on the marketing side today, just -- but just curious if you can maybe add on what you're seeing on the M&A side currently out there. I know we're early here on the Index post the December Analyst Day, and the acquisition that you guys referenced to longer-term in your forecast there. But just curious where that stands today, if you know timing-wise, if we should think about that as a longer-term, more of a longer-term event than anything near term? Any color there?

Greg Goff - Tesoro Corporation - Chairman & CEO

I think, first, just to restate what was mentioned earlier, we are seeing good growth in our wholesale jobber business. As we mentioned, and maybe both Steven and I, that, that is up about 8% year on year, which is -- it's -- that's very favorable because that's one of our target areas of growth. That's a first point.

The second point is other activity in our area has actually been raw price, it was paid was above what we would be willing to pay. We just didn't offer -- see an opportunity there. Other than that, it's been relatively quiet so we're very focused on looking at other -- the opportunities to continue to grow our business and also to improve our existing business there.

And you stated it very clearly, our -- what we laid out in the end of 2015 was our approach over time that we would look at those opportunities and target between 2016, 2017, and 2018 to deliver that growth in marketing.

Igor Grinman - Deutsche Bank - Analyst

Thanks. I appreciate that. And maybe just one more, just to switch gears a little bit to the refining side. I guess a lot of the focus today has been more on the West Coast side and maybe some of the capture weakness, the unplanned downtime that you saw in Q2. But the Mid-Con, which was pretty positive this quarter, we saw a pretty dramatic sequential uptick.

Just curious as to how sustainable that results out there is and maybe just some kind of drivers you can point to in the quarter? I only ask because a lot of the peers have actually seen pretty sizable drops quarter on quarter so just contrary to what has happened out there?

Greg Goff - Tesoro Corporation - Chairman & CEO

Yes I think we did run well this quarter within the region. Also, our Great Northern acquisition, with just this acquisition, because we haven't dropped down it yet is also within that region. So some of the favorability you see is from that. That will continue because that asset is performing extremely well versus our original expectations.

Igor Grinman - Deutsche Bank - Analyst

Great. I appreciate it, guys.



Greg Goff - *Tesoro Corporation - Chairman & CEO*

Thank you.

Operator

Phil Gresh of JPMorgan.

Phil Gresh - *JPMorgan - Analyst*

Hey Greg. Good morning.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Hi, Phil. First question is on your droppable EBITDA. I was just curious, where you stand today on total droppable EBITDA after you complete what's planned for 2016? And does it all sit in refining at this point? I know you've had some EBITDA move from refining to retail but I don't believe wholesale was part of that EBITDA. Maybe just an update on that front? So Phil, if you just reflect back on what we said at -- in December of last year, I think we broke it down into two pieces. The first piece we said was that with the existing assets in the Company, we had somewhere -- I'm just going off of memory here, but something between \$350 million to \$500 million of EBITDA that's attributable to those assets.

And then we said we had another \$150 million to \$250 million or so with things that we were working on that would ultimately be dropped down in there and that hasn't changed. That is unchanged from what we said then so what have we done? Well, one, what we talked about earlier we have now sold part of what was in that part of the EBITDA, in that, let's call it, the legacy Tesoro assets, which was the Alaska assets around the Kenai Refinery.

But in addition, from the other bucket, the opportunities we are dropping down the acquisition that we did from Flint Hills Resources, so that gives you that EBITDA number that came with that. Then the only other change is, instead of taking the EBITDA that would have come from opportunities which is the Great Northern and drop it down in the second half of this year.

As I mentioned, we'll move that out of 2016 and bring forward what we plan to do with Martinez, that I think in the press release, gave an EBITDA number of -- I don't even remember what that number is -- what is it? Around \$50 [million] -- up to about \$50 million so that you can just see how that affects the two buckets of opportunities that we talked about so not a big change.

Phil Gresh - *JPMorgan - Analyst*

Okay. Got it. My second question is just on the CapEx, the reduction in the CapEx. Any reduction in your sustaining capital requirements relative to what you thought before or is this all on growth CapEx? The reason I ask is because going back to the Analyst Day, there's a really big step up in sustaining capital for 2016 relative to what we've seen historically.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, so we -- in our sustaining capital, we had a portion of our compliance with the consent decree which we have talked about probably now for two or three years but then we've been working on that stages of wrapping up our expenditures on the consent decree.



And there's -- there haven't been any material changes in our sustaining capital spend other than that so it's most of it, as we stated earlier, was attributable to the timing of the permitting for the projects versus what we thought we would do in 2015, move those -- move that spend out into 2017, 2018.

Phil Gresh - *JPMorgan - Analyst*

Okay. Got it. If I could just sneak one last question in. Could you potentially quantify the lost opportunity costs from the second quarter for refining and if you have it by region?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Phil, I mean, to get back into that level of detail, it's something that I prefer not to do but you can -- if you take our guidance on crude runs and the midpoint of our guidance on what we said we were going to do in the second quarter and what we actually did, gives you an indication of how far off we are.

And that, I will tell you is absolutely attributable to doing some additional work at the Kenai Refinery, once we had refinery down. We took the whole plant down and did an extensive turnaround at Kenai and that took longer. And secondly, the operating problems and maintenance that we did in the California System are solely attributable to the impact on our crude runs.

Secondly, if you go back, while you look at our capture which we disclosed versus we have said we thought we'd be in the very low 80% for 2Q, that tells you -- that answers your question.

Phil Gresh - *JPMorgan - Analyst*

So to ask it another way, you're comfortable with that low 80% capture in the third quarter?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes.

Phil Gresh - *JPMorgan - Analyst*

Okay. Thanks.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

I think -- I'd just like to add one point. I think what's important is that we were able to go back in during the second quarter and the operating problems we identified, we have actually dealt with those and they are behind us. And we are now running very, very well and expect to throughout the rest of the year and have a little bit of maintenance at -- in the fourth quarter but relatively low maintenance going forward between now and the end of the year.

Phil Gresh - *JPMorgan - Analyst*

Okay. Great. Thanks, Greg.



Operator

Paul Cheng of Barclays.

Paul Cheng - Barclays Capital - Analyst

Hey guys. Good morning.

Greg Goff - Tesoro Corporation - Chairman & CEO

Hi, Paul.

Paul Cheng - Barclays Capital - Analyst

Greg, just curious, that, I mean, there is a number of very large pipeline going to Source oil from Bakken that's going to come on stream in the coming months into 2019, 2020. So from that standpoint, are you concerned you may not actually have sufficient oil from Bakken, trying to figure even if you get the approval from the Vancouver Project?

Greg Goff - Tesoro Corporation - Chairman & CEO

The -- we believe Paul, that the cost structure that we have will allow us to compete very effectively with the pipelines. The challenge will be that people who commit to those pipelines have an obligation to either pay or ship on the pipeline so our system, because fortunately we have both a gathering, a storage, and a pipeline system, allows us to go out with our relationships with the producers by, at the least, and move it into our system. So the competition may be greater but we don't -- we're not concerned that will be short supply, to answer your question.

Paul Cheng - Barclays Capital - Analyst

Okay. Steven, next two questions just for you, do you have any hedging gain or loss in the second quarter, that is not fully offset by the corresponding value change in the physical barrels?

Steven Sterin - Tesoro Corporation - EVP & CFO

No, nothing material, Paul.

Paul Cheng - Barclays Capital - Analyst

Nothing material and we shouldn't assume that heading into the third quarter, there's any material hedging gain or loss starting with the quarter, right?

Steven Sterin - Tesoro Corporation - EVP & CFO

No, Q2 didn't have any effect at the end of the quarter; that would roll into Q3, so no issue with that.



Paul Cheng - Barclays Capital - Analyst

Okay. And going back to your earlier comment that if you're comparing year to date, your results comparing to 2014, you did not drop as much as your competitor and that is the proof for the synergy benefit. I probably got it wrong, but if I look at it somewhat differently, region by region, if I look at your Pacific Northwest and your California System as one as the entire West Coast for the last four quarters, rolling four quarter, your EBITDA per barrel is about \$7.80, which is about \$3 higher than your 2014 average, which is great.

The only problem is that Phillips 66 and Valero look like they are up about \$3.90 and \$6.40 per barrel so they actually improved far more. Now if I'm looking in your inland system, your Mid-Con, in the same period, that you dropped about \$9, because the defense have dropped a lot.

But if I am looking at the inland system from Philips 66, Valero, (inaudible) Western together, they drop, I believe, more than \$3. So maybe I'm just looking at it totally wrong but that doesn't seem like it suggests you guys have improved compared to your peers.

Steven Sterin - Tesoro Corporation - EVP & CFO

Yes, so I think a couple of comments. First, it's the overall earnings of the Company, Paul, not just pointing through a refining segment, which very importantly for us, because we run a very integrated, highly integrated business into marketing and what we've been able to do on a relative basis with our marketing business back to where we were in 2014, as well as the substantial growth we've had in our Logistics business. So across the Company, that's where the comment was geared.

Paul Cheng - Barclays Capital - Analyst

Maybe then it would be helpful if you have Sam or someone on your team would be able to get maybe in one of your presentation due some reconciliation so that -- to help us understand how that difference from refining into the total company because --

Steven Sterin - Tesoro Corporation - EVP & CFO

Versus others. Because it seems like -- I mean, I just have some difficulty to reconcile myself. We can do that over time.

Paul Cheng - Barclays Capital - Analyst

Okay. Very good. Thank you.

Steven Sterin - Tesoro Corporation - EVP & CFO

Thanks, Paul.

Operator

Ed Westlake of Credit Suisse.

Ed Westlake - Credit Suisse - Analyst

Yes, good morning. Really a question on the TLLP. You've done a fantastic -- good morning, Greg. You've done a fantastic job of getting EBITDA up \$950 million, I think is the consensus now for next year. You're on a 7% yield which is wider than the growth MLPs because I guess people are just saying, how can you go to the next level?

Obviously, the drops help and the organic investment but maybe talk a little bit about your more strategic thoughts about top-of-funnel feeding of the MLP piece. Thank you and then a follow-up.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, so on TLLP, two key points. One is the organic growth opportunities. We're very focused on driving organic growth in the business. We've mentioned that it's been a little bit slower than we expected.

We have -- we actually have a reasonably good portfolio of ideas that we're looking at right now and we are encouraged by those. So we will talk more about those as they develop in that but that organic growth is a key part of Tesoro Logistics growth. It's actually our preferred way to grow the Company.

The second is around acquisitions and the market for acquisitions is probably hasn't changed a lot of what we've seen over time. So the -- there's a number of things that we're looking at that we're encouraged by so the -- both the combination of the organic growth and the acquisitions look very encouraging to us.

Ed Westlake - *Credit Suisse - Analyst*

And that's probably a good follow-on for my second question, which is around building cash in the second half from the drops and running well and we'll see what margins do, but there's, obviously, how much do you buy back? How much do you build cash to basically build up to being able to do something on the M&A side in whichever segment makes most sense?

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Was that a question or a statement?

Ed Westlake - *Credit Suisse - Analyst*

Sorry. The question was buybacks versus cash [generation] --

Greg Goff - *Tesoro Corporation - Chairman & CEO*

I'm sorry. Okay.

Steven Sterin - *Tesoro Corporation - EVP & CFO*

The types of acquisitions that we've talked about today, and I mentioned in my comments we see opportunities in the midstream space and some other smaller type opportunities. And we think that we have the appropriate cash generation to allow us to do both.

Obviously, if new opportunities come up, we continue to rebalance those and do which ones create the most value for shareholders but I think we're well-positioned right now, when you look at where we are with cash today, what we said about drops, and how we -- what we told you about how we expect to operate in the second half that we've got plenty of flexibility, Ed.

Ed Westlake - *Credit Suisse - Analyst*

Okay. Thanks very much.

Operator

Faisal Khan of Citigroup.

Faisal Khan - Citigroup - Analyst

Thank you. Good morning, Greg. Good morning, Steven.

Steven Sterin - Tesoro Corporation - EVP & CFO

Hi, Faisal.

Faisal Khan - Citigroup - Analyst

Hi. YOU said -- as I'm looking at the drops for TLLP, sort of the \$91 million to \$111 million in drops, historically I guess that EBITDA used to reside within refining, the (inaudible) resided in refining, so is that compare future refining results versus past refining results? Am I comparing apples to oranges and do I need make an -- going backwards in time to make sure I'm capturing the relative capture rate of refining versus the benchmarks?

Steven Sterin - Tesoro Corporation - EVP & CFO

Yes, Faisal, it's Steven. No, you're right; that's an excellent point. If you look at -- although, a lot of the growth within our Logistics business has come from organic growth and acquisition. We have done, on a relative basis, a pretty substantial amount of drops in the last several years and I think that also goes back to the question asked earlier about Paul.

But you're right. If you want to go back and look at our business on a non-drop basis to look over time, we've said about half of the earnings or half of the revenues from TLLP, maybe a little bit north of that come from Tesoro. And so if you want to go back and look at it on a consistent basis, you would need to do that.

Faisal Khan - Citigroup - Analyst

Okay. Fair enough. The announcement yesterday on the consolidation of -- by some developers of two Bakken Pipelines to consolidate those two assets, Sandpiper and DAPL. Does that -- on the margin, is that beneficial to you? How do you guys see that strategically for your position in the Bakken?

Greg Goff - Tesoro Corporation - Chairman & CEO

Faisal, it goes back to some of the earlier questions about the overall dynamics of additional pipeline capacity coming on in the -- I mean, one of the pipelines, the DAPL pipeline was well-established and was always going to come on. The other pipeline maybe was somewhat questionable.

So we don't think it has a substantial impact on what happens up in North Dakota, that volumes that will move off of the DAPL pipeline into the Gulf coast were going to be there and then what's important for us is that because of the way that we collect and move barrels up there we feel we are well-positioned to be able to meet our demand for crude oil to take it to the West Coast.

Faisal Khan - Citigroup - Analyst

Okay. And then on acquisitions, would Burnaby or Cherry Point, would any of those assets make sense for you guys? And how do you look at the operating environment in Western Canada versus the Northwest US?

Greg Goff - Tesoro Corporation - Chairman & CEO

I don't know that much about Burnaby, to be quite honest with you so, we look at everything. Like we've always said, we feel like we understand our geographic area reasonably well and we know where there's opportunities that would fit into us. Right now, it's actually very quiet so we would just look at opportunities as they became available.

Faisal Khan - Citigroup - Analyst

Okay. Understood. Thanks guys. I appreciate the time.

Greg Goff - Tesoro Corporation - Chairman & CEO

Thank you.

Operator

Spiro Dounis of UBS.

Spiro Dounis - UBS - Analyst

Hi gentlemen, and thanks for squeezing me in. Good morning. I'm just go ahead and keep these brief, a little over an hour here, so just one follow-up on the capacity and utilization guidance provision. So it seems like we probably should have seen it coming, just based on your comments in the first quarter call, saying it was tracking below.

And so I guess as we head into the back half of this year. I don't know if you guys have injected any sort of conservatism in that new guidance range and maybe what you need to see, if there's anything out there that can make it go down again?

Greg Goff - Tesoro Corporation - Chairman & CEO

If you're talking about our guidance for the third quarter, it's a very good indicator of what we expect to happen for Q3.

Spiro Dounis - UBS - Analyst

Actually, it was more than \$100 million reduction in the capture and utilization guidance. Sorry.

Greg Goff - Tesoro Corporation - Chairman & CEO

Yes, thanks for the clarification. The point that I made regarding what's happening in 2016 relative to what we stated at our Analyst Meeting, part of what we said there was when we looked at how the system ran in 2015, primarily impacted by the work stoppage in that we experienced, the recapture that -- in 2016, was worth that \$500 million to \$600 million and the \$100 million that we reduced that by is a reflection of what happened in the second quarter.

Spiro Dounis - UBS - Analyst

Got it. Okay. That's helpful. And then just one follow-up on Dakota Prairie, which I guess is now Dickinson. Just in terms of the timing of when you expect to extract the 20 million-plus in synergies. How should we thinking about that? Is it ratable or does it actually just occur in a lump sum at some point?

Greg Goff - Tesoro Corporation - Chairman & CEO

Yes. We'll capture a lot of that. I would suspect that, by the end of the year, we will have captured all of it.

Spiro Dounis - UBS - Analyst

Got it. That's it for me. I appreciate the color.

Greg Goff - Tesoro Corporation - Chairman & CEO

Thank you.

Operator

We have time for one more question. Doug Leggett of Bank of America.

Doug Leggate - BofA Merrill Lynch - Analyst

Thanks. Good morning, gentlemen. I managed to break the queue this morning, just I don't know exactly but I dropped out.

Greg Goff - Tesoro Corporation - Chairman & CEO

That's all right.

Doug Leggate - BofA Merrill Lynch - Analyst

I'm sorry. Thanks for squeezing me on. I know a lot of things have now been asked but the one issue I wanted to come back to, if I may, is this issue of the strength of your cash flow that's obviously in front of you over the next six to 12 months. I want to understand, make sure I understand correctly what your priority is for the use of that cash and specifically on the potential for retail acquisitions.

It's obviously become topic of year again, the relative volume of retail compared to refining and that bolt-on question, if you could talk to your thoughts on how you see maximizing the value of your what's clearly valuable retail business. I will leave it there. Thank you.

Greg Goff - Tesoro Corporation - Chairman & CEO

All right. Thanks Doug.



Steven Sterin - *Tesoro Corporation - EVP & CFO*

Hey Doug. As we said before, as we look over the next several years at potential marketing acquisitions, they would need to come from lower-cost sources of capital, as we've talked before. So as we sit here now and look today, it wouldn't -- not be our priority to use the types of cash that we talked about on call today to do any material marketing acquisition. The smaller ones potentially but I would not think about marketing acquisitions as a large use of the type of cash flows that we generate from the current portfolio.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Yes, I would just add to Steven's comments, as we look forward, we are absolutely committed to taking a portion of our free cash flow and most of it goes back into the big refining projects that we're working on right now. And so we are, one, those -- the nature of those projects are very, very valuable to the Company.

And so as we go back in, for example, the Los Angeles Integration Compliance Project, that project, I think we said is somewhere around the \$450 million capital spend amount and generates over \$100 million of EBITDA. And more importantly, provides other benefits like the reduction in CO2 and things like that. That it is a very impactful use of capital.

And so we are committed to take a portion of our free cash flow, reinvest it into business into very high returns, value-adding projects and then have that rest of that free cash flow available to do as we've done in the past and make it available to return to shareholders.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Well, I know it's not an easy question to answer, so I appreciate you squeezing me in, Greg. Thanks very much.

Greg Goff - *Tesoro Corporation - Chairman & CEO*

Thanks, Doug. Good talking to you.

Operator

Ladies and gentlemen, that concludes our question-and-answer session and it does conclude our call for today. Thank you for participating in today's conference. You may all disconnect. Everyone have a wonderful day.

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