Andeavor First Quarter 2018 Webcast Transcript

Date: May 7, 2018
Presenters: Greg Goff, Chairman and CEO
Steven Sterin, President and CFO
Brad Troutman, Vice President, Investor Relations

Brad Troutman:

Good afternoon. This is Brad Troutman, Vice President of Investor Relations, and I would like to thank you for joining our webcast covering progress of our strategic plans and our first quarter 2018 earnings. This webcast will be presented by Greg Goff, Chairman and CEO and Steven Sterin, Executive Vice President and CFO.

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

Our comments during this webcast will include forward-looking statements that refer to management's expectations or future predictions. These statements are made as of the date of this webcast and we are under no obligation to update these forward-looking statements in the future. They are subject to risks and uncertainties that could cause actual results to differ from our expectations. Please refer to the earnings release for additional information on forward-looking statements. Now, I will turn the webcast over to Greg.

Greg Goff: Thanks, Brad.

We are very excited about the recently announced strategic combination of Andeavor and Marathon and are confident this action will create significant shareholder value. More information regarding this proposed transaction can be found on our website. We are also excited to share our first quarter results and progress we are making towards achieving our synergies and growth targets. We are focused on continuing to strengthen our business and executing on the plans we communicated at our Investor and Analyst Day in December, as well as the recently announced strategic actions that are additive to those plans.

Starting with our first quarter performance,

Our integrated business model allowed us to deliver strong results during the quarter. The margin environment in the first half of the quarter was slightly below normal historical levels, mostly due to high 2017 ending inventories across the West Coast. However, that is behind us, and inventory levels, demand, crude oil differentials and refining and marketing margins continue to improve across our entire business, which we saw in the latter part of the first quarter and are clearly seeing in the second quarter. Our business is performing very well and in line with our expectations for 2018.

We are making excellent progress with the execution of our growth plans outlined at our 2017 Investor and Analyst Day. Andeavor Logistics has already raised its 2018 to 2020 growth target to $965 million of net earnings and EBITDA by approximately $150 million to $1.6 billion as a result of the recently announced acquisitions and strategic projects in the Permian Basin. In addition, we recently announced the following acquisitions and strategic projects:

- First, we have taken a strategic equity position in the Gray Oak pipeline and the South Texas Gateway Terminal, which further strengthens our Permian strategy and aligns with our integrated business model, allowing our customers to access multiple markets on the U.S. Gulf Coast as well as other markets through the announced marine terminal. The benefits from these investments are not included in our growth plans. As these projects progress, we will share more information about the value creation related to these investments.
- Second, Andeavor Logistics' acquisition of the Wamsutter Pipeline on May 1st will increase the Salt Lake City Refinery's access to advantaged crude oil,
- And, third, our announced acquisition of five asphalt terminals from Delek allows for additional growth and enhanced returns on our refining production.

In the first quarter, we returned $348 million to shareholders in the form of share repurchases and dividends and invested $244 million in high-return income capital projects. We repurchased $256 million of shares at an average price of $97.96 per share.

Now, I would like to update you on our integration of Western Refining and Western Refining Logistics, which is progressing very well and our delivery of synergies is on schedule. We continue to have a successful integration and are moving forward towards full integration and synergy capture.

We exited the first quarter at a run rate of $250 million in synergies, and we are on track to deliver a synergy run rate of $350 to $425 million by mid-2019. The synergy run rate achieved by the first quarter consists of approximately $120 million of corporate efficiencies and approximately $130 million in value chain optimization, marketing and operational improvements.

Turning to our business segments,

First, within our Marketing business,

We are committed to driving growth in our Marketing business by adding new retail sites to the network, placing product into the highest-value branded distribution channels and growing our non-fuels convenience business.

We increased our branded and retail store count by 31%, or 787 stations year-over-year, to 3,300 in the first quarter primarily as a result of the Western Refining acquisition. Marketing fuel margins were 16.2 cents per gallon for the Retail and Branded channel for the first quarter, and we are seeing improvements in the market in the second quarter as we enter the summer driving season and continue to see strong demand for our products across our business.

Our Marketing business' organic growth plan execution has resulted in the addition of 45 net new branded stations in the first quarter, so we continue to make excellent progress. We expect to convert a total of 50 stations to company operated in the first half of 2018. These conversions allow us to capture additional non-fuel margins and enhance overall station profitability. Upon completion of these 50 conversions, we will have converted 100 stations from MSO to company operated.

We are now also supplying fuel to approximately 82 stations in Northwest Mexico, including 57 under the ARCO brand. We expect to increase our marketing presence across the entire northern part of Mexico with an estimated 250 to 300 stores planned through 2020. And, we continue to believe there is substantial growth beyond 2020.

We remain excited about the growth prospects in our Marketing business as we expand our network and converting more stations to company operated, which allows us to capture more value per station.

Moving to our Logistics business,

During and shortly after the quarter, Andeavor Logistics completed several strategic actions that will contribute to its continued growth in 2018. We recently increased our 2020 Logistics segment operating income target to $1.2 billion from $1.1 billion and segment EBITDA by $150 million, bringing the total segment EBITDA growth target to $1.6 billion from $1.5 billion communicated in December. These transactions included:

- An acquisition of the Wamsutter Pipeline System, which closed on May 1st,
- The announcement and commencement of construction of the North Dakota NGL Logistics Hub, a NGL fractionation and distribution project in the Bakken,
- Andeavor's acquisition of Rangeland Energy, with the intention to drop down the crude oil pipeline and storage assets to Andeavor Logistics this year, and
- The addition of three new crude oil gathering systems in the Permian Basin with high quality producers, which brings our total acreage commitments in the region to 72

thousand acres and we are on our way to delivering $150 million in annual segment operating income and $200 million in segment EBITDA by 2020

Our focus on high return investment, customer excellence and project execution positions us for further growth as a leading customer focused, full-service logistics company.

We announced today that we expect to offer assets for sale to Andeavor Logistics. This set of assets includes the RIO pipeline and the remaining Permian assets as well as Terminalling and Transportation assets across our refining system. The assets also include the Conan Crude Oil Gathering System and the Los Angeles Refinery Interconnect Pipeline. In total, we expect the value of these assets to be approximately $1.6 to $1.7 billion with about 50 to 60% as cash consideration to Andeavor and the rest in the form of additional MLP units issued to Andeavor. We expect to close on this transaction in August 2018.

The growth in our Logistics business continues to bring more stable, fee-based earnings and cash flow to Andeavor and allows Andeavor investors to participate in the highly accretive third party organic growth in the Permian.

Shifting to our Refining business,

Total refinery throughput for the quarter was 1,037,000 barrels per day, which was in line with our expectations and reflects the previously communicated planned major maintenance activities. This represents 90% utilization. Additionally, our refining margins were $10.85 per barrel.

We successfully completed our planned maintenance at both of our California and Salt Lake City refineries in the first quarter, and we are currently completing turnarounds at our Anacortes and Kenai refineries. We continue to take advantage of our planned downtime in order to optimize our system and fully prepare for IMO 2020, from which we expect to see the benefits in late 2019.

We are excited about the progress we are making with our Los Angeles Refinery Interconnect and Compliance Project (LARIC). This project enhances our product yield flexibility in Southern California and significantly reduces greenhouse gas and other pollutant emissions. This project will result in additional flexibility to make about 30 to 40 thousand barrels a day more of diesel or jet fuel instead of gasoline, dependent upon demand. This flexibility will deliver significant benefits, with the potential for upside with the upcoming IMO specification changes. The project is on track to deliver annually $75 million of net earnings and $125 million of EBITDA growth after completion in late 2019. This earnings improvement and timeline is consistent with the targets discussed at our Investor Day and does not include any incremental benefits related to IMO.

The Isomerization Project at our Anacortes refinery, which increases octane production capability, meets Tier III sulfur requirements and reduces operating costs, is under construction and on schedule to be completed in second quarter 2018. This project will deliver approximately $20 million in net earnings and $40 million in EBITDA per year upon completion, which is consistent with our commitments.

Looking ahead, we remain focused on driving stronger operational performance and reliability, as well as delivering on our growth, productivity and synergy targets totaling $1.1 billion of additional net earnings and $1.6 billion of additional EBITDA by 2020.

With that, I'll turn it over to Steven to provide more detail of the first quarter financial and operational results.

Steven Sterin: Thanks, Greg.

Andeavor reported first quarter 2018 earnings from continuing operations of $164 million, or $1.07 per diluted share, compared to $50 million, or $0.42 per diluted share a year ago.

Consolidated net earnings were $237 million for the first quarter compared to $87 million for the same period last year and EBITDA was $680 million compared to $432 million a year ago.

Keep in mind, the first quarter results include the following pre-tax items:

- $19 million of acquisition and integration costs primarily related to the Western Refining acquisition and
- Approximately $100 million net benefit in some of the Inland refineries primarily related to lower RIN costs

Turning to our business segments,

In our Marketing business, for the quarter,

Segment operating income was $128 million and segment EBITDA was $152 million compared to segment operating income of $133 million and segment EBITDA of $146 million a year ago.

Total fuel margins for the first quarter were 9.1 cents per gallon versus fuel margins of 9.6 cents per gallon last year. Retail and Branded fuel margins were 16.2 cents per gallon compared to 17.4 cents per gallon in 2017.

Merchandise margin increased to $50 million from $3 million in 2017, primarily due to the Western Refining acquisition and the conversion of MSO sites to company operated stations, which allow the capture of non-fuel profits.

We continued to grow our network of retail and branded stores, growing store count by 787, or 31% year-over-year, to 3,300. This was primarily driven by the additional stores from the Western Refining and Northern California Retail acquisitions and the continued execution of our organic growth plan, including rebranding and expansion into Mexico.

Shifting to our Logistics business, for the quarter,

Segment operating income increased to $188 million from $150 million a year ago and segment EBITDA grew to $271 million versus $212 million last year.

The segment's results included an $8 million unfavorable impact due to Andeavor refinery planned maintenance in the quarter. This was in line with our expectations.

The year-over-year increase in segment operating income and segment EBITDA was primarily driven by contributions from the Western Refining Logistics acquisition, contributions from 2017 drop downs, and organic growth.

In addition to the projects Greg mentioned, we also expanded our recently acquired RIO Pipeline from the Delaware Basin to the Midland Market Hub to 80 thousand barrels per day and based on recent nominations, we expect to be at full capacity by the end of the second quarter. We are executing further incremental capacity expansions to strengthen access to Midland and enhance our Permian position.

The total distributions received from Andeavor Logistics were $115 million during the first quarter, an increase of $38 million or 49% from a year ago.

We announced our plans for a $1.6 to $1.7 billion drop down in August 2018, which is expected to include Permian assets and refining logistics assets, including the Conan Crude Oil Gathering system and the Los Angeles Refinery Interconnect Pipeline. Accomplishing the 2018 to 2020 drop downs this year is expected to provide increased growth visibility, allow for more efficient operational management of the assets, capture the growth of our Permian strategy and maintain reporting transparency as changes in lease accounting standards become effective in 2019.

Moving to our Refining business,

Our segment operating income for the first quarter was $205 million compared to segment operating income of $34 million a year ago and segment EBITDA was $387 million versus $181 million last year.

Refining margin for the first quarter was $1.0 billion, or $10.85 per barrel. This compares to a refining margin of $701 million, or $9.44 per barrel last year.

Total Refining crude oil throughput for the first quarter was 1,037,000 barrels per day, or 90% utilization, which was in-line with our guidance.

Consolidated manufacturing costs in the first quarter decreased 8 cents per barrel over the same period last year to $5.59. The year-over-year decrease is due our continued focus on driving productivity to offset inflation and the realization of our Western Refining synergies.

Our corporate and unallocated costs for the first quarter 2018 were $151 million and included $19 million of acquisition and integration costs, which was modestly below our guidance. We continue to achieve our planned synergies in this area and remain disciplined with our spending. As a result of our actions and cost discipline, we expect a similar run-rate in second quarter 2018 which is reflected in our updated guidance. We remain committed to delivering on the Western Refining synergies and continued productivity we are demonstrating in our corporate functions.

Now, let me take a moment to discuss our balance sheet, cash flow and our strategic priorities for creating long-term shareholder value.

Total debt, net of unamortized issuance costs, was $8.7 billion at the end of the quarter. Excluding Andeavor Logistics, debt was $4.6 billion.

Turning to cash flows,

Andeavor generated cash flow from operating activities of $250 million in the first quarter. Please keep in mind that $178 million in turnaround and marketing branding spending is included in our operating cash flows for the quarter.

In the first quarter, we invested in $244 million in high-return, growth capital projects at Andeavor and Andeavor Logistics, primarily driven by our Permian growth investments, LARIC, and the Isomerization project Greg mentioned a moment ago.

We repurchased 2.6 million shares for approximately $256 million in the first quarter. Additionally, we paid dividends of $92 million and Andeavor Logistics distributed $99 million to its public unitholders during the quarter.

We also announced that the Andeavor board of directors declared a quarterly cash dividend of $0.59 per share, payable on June 15, 2018 to all holders of record as of May 31, 2018.

Our continued commitment to capital allocation discipline, a strong balance sheet and commitment to executing our growth plans position us to continue to create significant shareholder value.

Looking ahead, you can find details of our planned throughput, manufacturing costs per barrel and other elements related to our second quarter 2018 outlook in our earnings release.

This concludes the webcast. Thank you.

Forward-Looking Statements

This communication contains forward-looking statements within the meaning of federal securities laws regarding Andeavor ("ANDV"). These forward-looking statements relate to, among other things, the proposed transaction between ANDV and Marathon Petroleum Corporation ("MPC") and include expectations, estimates and projections concerning the business and operations, strategic initiatives and value creation plans of ANDV and Andeavor Logistics ("ANDX"). In accordance with "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995, these statements are accompanied by cautionary language identifying important factors, though not necessarily all such factors, that could cause future outcomes to differ materially from those set forth in the forward-looking statements. You can identify forward-looking statements by words such as "anticipate," "believe," "could," "design," "estimate," "expect," "forecast," "goal," "guidance," "imply," "intend," "may", "objective," "opportunity," "outlook," "plan," "position," "potential," "predict," "project," "prospective," "pursue," "seek," "should," "strategy," "target," "would," "will" or other similar expressions that convey the uncertainty of future events or outcomes. They include, without limitation, statements concerning: our operational, financial and growth strategies, including continued growth, disciplined capital allocation, enhancing our integrated business model, investing in high-return capital projects, pursuing strategic acquisitions, returning cash to our shareholders, driving growth and improvements, and delivering synergies; our ability to successfully effect those strategies and the expected timing and results thereof; our financial and operational outlook, and ability to fulfill that outlook; our financial position, liquidity and capital resources; expectations regarding future economic and market conditions and their effects on us; the announced acquisition of Andeavor by Marathon, including expected timing and benefits thereof; statements regarding the execution of growth plans outlined at our 2017 Investor and Analyst Day; 2018 to 2020 Andeavor Logistics targets for net earnings and EBITDA; statements regarding Andeavor Logistics' announced projects and acquisitions; delivery of synergies, including expected annual run-rate synergies from the Western acquisition and the sources thereof; the amount and timing of future dividends; expectations regarding the Gray Oak Pipeline and the South Texas Gateway Terminal joint ventures, including timing, the quality, capacity and capabilities of the projects, and the expected benefits thereof; our plans to integrate the pipeline and marine terminal with our operations, and the expected benefits therefrom; our strategy to drive growth in our marketing business and the expected results thereof; plans to complete the Anacortes isomerization project and the expected timing thereof;

statements regarding our 2018 to 2020 drop down plans, including the expected drop down of Permian and refining logistics assets, the Conan Crude Oil Gathering System and the Los Angeles Refinery Integration Pipeline to Andeavor Logistics and the expected benefits and timing thereof; statements regarding the planned West Coast asphalt terminals acquisition, including the expected timing and benefits thereof; preparations for IMO 2020, and the expected benefits therefrom; second quarter and full year 2018 guidance and expectations; statements regarding the LA refinery integration and compliance and Anacortes isomerization projects, including projected 2020 net earnings and EBITDA therefrom; projected Logistics Segment operating income and EBITDA; and projected operating income and EBITDA contribution of the Permian Systems; original and revised 2018 to 2020 Andeavor growth strategy projected net earnings and EBITDA, including the components thereof; and other aspects of future performance.

Such forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and other factors, some of which are beyond the companies' control and are difficult to predict. Factors that could cause ANDV's actual results to differ materially from those implied in the forward-looking statements include: the ability to complete the proposed transaction between ANDV and MPC and on anticipated terms and timetable; the ability to obtain approval by the stockholders of ANDV and MPC related to the proposed transaction and the ability to satisfy various other conditions to the closing of the transaction contemplated by the merger agreement; the ability to obtain governmental approvals of the proposed transaction on the proposed terms and schedule, and any conditions imposed on the combined entities in connection with consummation of the proposed transaction; the risk that the cost savings and any other synergies from the proposed transaction may not be fully realized or may take longer to realize than expected; disruption from the proposed transaction making it more difficult to maintain relationships with customers, employees or suppliers; risks relating to any unforeseen liabilities of ANDV; future levels of revenues, refining and marketing margins, operating costs, retail gasoline and distillate margins, merchandise margins, income from operations, net income or earnings per share; the regional, national and worldwide availability and pricing of refined products, crude oil, natural gas, NGLs and other feedstocks; consumer demand for refined products; our ability to manage disruptions in credit markets or changes to our credit rating; future levels of capital, environmental or maintenance expenditures, general and administrative and other expenses; the success or timing of completion of ongoing or anticipated capital or maintenance projects; the reliability of processing units and other equipment; business strategies, growth opportunities and expected investment; MPC's share repurchase authorizations, including the timing and amounts of any common stock repurchases; the adequacy of our capital resources and liquidity, including but not limited to, availability of sufficient cash flow to execute our business plan and to effect any share repurchases, including within the expected timeframe; the effect of restructuring or reorganization of business components; the potential effects of judicial or other proceedings on *our business, financial condition, results of operations and cash flows; continued or further volatility in and/or degradation of general economic, market, industry or business conditions; compliance with federal and state environmental, economic, health and safety, energy and other policies and regulations, including the cost of compliance with the Renewable Fuel Standard, and/or enforcement actions initiated thereunder; the anticipated effects of actions of third parties such as competitors, activist investors or federal, foreign, state or local regulatory authorities or plaintiffs in litigation; the impact of adverse market conditions or other similar risks to those identified herein affecting MPLX LP and ANDX; and the factors set forth under the heading "Risk Factors" in ANDV's Annual Report on Form 10-K for the year ended December 31, 2017, subsequent Quarterly Reports on Form 10-Q, and other filings with the Securities and Exchange Commission (SEC). We have based our forward-looking statements on our current expectations, estimates and projections about our industry. We caution that these statements are not guarantees of future performance and you should not rely unduly on them, as they involve risks, uncertainties, and assumptions that we cannot predict. In addition, we have based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. While our management considers these assumptions to be reasonable, they are inherently subject to significant business, economic, competitive, regulatory and other risks, contingencies and uncertainties, most of which are difficult to predict and many of which are beyond our control. Accordingly, our actual results may differ materially from the future performance that we have expressed or forecast in our forward-looking statements. We undertake no obligation to update any forward-looking statements except to the extent required by applicable law.*

No Offer or Solicitation

This communication relates to a proposed business combination between MPC and ANDV. This communication is for informational purposes only and is neither an offer to purchase, nor a solicitation of an offer to sell, any securities or the solicitation of any vote in any jurisdiction pursuant to the proposed transactions or otherwise, nor shall there be any sale, issuance or transfer or securities in any jurisdiction in contravention of applicable law. No offer of securities shall be made except by means of a prospectus meeting the requirements of Section 10 of the Securities Act of 1933, as amended.

Additional Information and Where to Find It

In connection with the proposed transaction, a registration statement on Form S-4 will be filed with the SEC. INVESTORS AND SECURITY HOLDERS ARE ENCOURAGED TO READ THE REGISTRATION STATEMENT AND ANY OTHER RELEVANT DOCUMENTS FILED WITH THE SEC, INCLUDING THE JOINT PROXY STATEMENT/PROSPECTUS THAT WILL BE PART OF THE REGISTRATION STATEMENT, WHEN THEY BECOME AVAILABLE, BECAUSE THEY WILL CONTAIN IMPORTANT INFORMATION ABOUT THE PROPOSED

TRANSACTION. The final joint proxy statement/prospectus will be mailed to stockholders of ANDV. Investors and security holders will be able to obtain the documents free of charge at the SEC's website, www.sec.gov, from ANDV at its website, www.andeavor.com, or by contacting ANDV's Investor Relations at 210-626-4757.

Participants in the Solicitation Relating to the Merger

MPC and ANDV and their respective directors and executive officers and other members of management and employees may be deemed to be participants in the solicitation of proxies in respect of the proposed transaction. Information concerning ANDV's participants is set forth in the proxy statement, filed March 15, 2018, for ANDV's 2018 annual meeting of stockholders as filed with the SEC on Schedule 14A. Additional information regarding the interests of such participants in the solicitation of proxies in respect of the proposed transaction will be included in the registration statement and joint proxy statement/prospectus and other relevant materials to be filed with the SEC when they become available.