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TLLP - Q1 2017 Tesoro Logistics LP Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Tesoro Logistics First Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded.

I would now like to introduce your host for today's conference, Mr. Sam Ramraj. Sir, you may begin.

Sam Ramraj - *Tesoro Corporation - VP of IR*

Good morning, and welcome to today's conference call to discuss our first quarter 2017 earnings. Joining me are Greg Goff, Chairman and CEO; Phil Anderson, President; and Steven Sterin, CFO.

The earnings release, which can be found on our website at tesorologistics.com, includes financial disclosures and reconciliations for non-GAAP financial measures that should help you analyze our results. Our comments and answers to questions during this call will include forward-looking statements that refer to management's expectations or future predictions. 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. Please also note, TLLP changed its operating segment presentation in the first quarter 2017 to reflect its expanded gathering and processing assets and operations. In our supplemental financial and operational information that is provided on our website, you can find historical results reflecting the new reporting structure.

Now, I will turn the call over to Greg.



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Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

Thanks, Sam. Good morning, and thank you for joining us today. We are pleased with our performance for the quarter, which included contributions from the strategic acquisition of the Northern California terminalling and storage assets and the North Dakota gathering and processing assets as well as organic growth from both our Crude Oil Gathering and Terminalling and Transportation businesses.

Despite harsher-than-normal winter weather conditions across our system, we had record throughput in crude oil and water gathering as well as our terminalling business, which contributed to strong operating income and EBITDA performance.

Let me now discuss our operating performance starting with gathering and processing. Crude oil and water gathering throughput for the first quarter 2017 increased 17% year-over-year to 253,000 barrels per day, and gas gathering and processing throughput increased 5% year-over-year to 952,000 MMBtus per day. This growth was primarily driven by strong contributions from the North Dakota gathering and processing asset acquisition we closed on January 1 as well as higher volumes from organic projects that we completed on our crude oil system in North Dakota.

Production of NGLs was lower year-on-year as Rockies production seasonally declined and was partially offset by production from the new North Dakota gathering and processing assets. We continue to see recovery in drilling activity in our basins, which is also generating new organic growth opportunities.

Turning to Terminalling and Transportation. Volumes for both terminalling and pipeline transportation increased approximately 12% and 1% year-over-year, respectively, for the first quarter. This was driven by higher throughput at our California marine terminals as well as contributions from the Alaska and California terminals we acquired during 2016.

Regarding the Los Angeles Refinery Interconnect Pipeline System project, Tesoro continues to work with the South Coast Air Quality Management District on the certification of our environmental impact report. Additional required permits are expected to be obtained within 90 days thereafter. These permits allow us to move forward with 2 important logistics projects, including the Los Angeles Interconnecting Pipeline System and the expansion of our crude oil storage capabilities.

Shifting to strategic investments. In January, we closed the North Dakota gathering and processing acquisition for approximately \$705 million. This business includes over 650 miles of crude oil and natural gas and produce water gathering pipelines; a 170 million cubic feet per day of natural gas processing capacity; and 18,700 barrels per day of fractionation capacity in the Williston basin in North Dakota.

The business is performing well and we continue to expect the North Dakota gathering and processing assets to contribute an estimated \$65 million to \$75 million of annual net earnings and \$100 million to \$110 million of annual EBITDA in 2017. Based on conversations with our customers and their drilling plans in our footprint, we are excited about the future organic growth prospects this business brings to TLLP.

Looking ahead, within Terminalling and Transportation, we should see the benefits from our recent expansions at many of our terminals in the Northwest Products System as we move into the typically higher seasonal spring and summer volumes. Additionally, we have several other projects in development that should enhance our flexibility and ability to lever crude oil into Tesoro's refining system as well as increased our capabilities to meet growing customer product demand for products.

Our strategy to grow the business is supported by our long-term capital structure. The Board of Directors of Tesoro has authorized management to evaluate and negotiate changes to the capital structure, including with respect to incentive distribution rights. We believe there are potential options that would enhance TLLP's competitive position and provide efficient access to capital as well as ensuring all unitholders benefit from the growth of the business.

We remain on track to delivering \$515 million of annual net earnings and \$1 billion of annual EBITDA in 2017. With more stable market conditions and the possibilities to improve TLLP's competitive position, we remain excited about our future and ability to grow value for our unitholders.

With that, I'll turn the call over to Phil to provide more details about the quarter.



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Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Thanks, Greg, and good morning, everyone. Yesterday, we reported first quarter net earnings of \$92 million, an increase from \$85 million a year ago; and EBITDA increased to \$210 million from \$175 million last year.

Net earnings and EBITDA for the first quarter of 2017 include approximately \$3 million of acquisition cost, primarily related to the North Dakota gathering and processing acquisition, which, as Greg mentioned, closed on January 1.

Shifting to our business segments. Gathering and processing segment operating income was \$62 million in the first quarter compared to \$64 million a year ago, and segment EBITDA was \$101 million versus \$100 million last year, a reminder that last year's quarter included a benefit of \$6 million for legal settlements.

Crude oil and water gathering throughput was 253,000 barrels per day, which was above our expectations and an increase of 37,000 barrels per day versus last year. During the quarter, we completed new inbound and outbound interconnections on the High Plains Pipeline System in North Dakota, which enhanced producers' optionality to move crude oil through our system to the different basin exit points. We also completed our second outbound interconnection to the Dakota Access Pipeline, which began receiving deliveries of crude oil during the quarter.

Gas gathering and processing throughput during the quarter increased to 952,000 MMBtu per day from 903,000 per day last year, which was primarily attributable to the contributions from the North Dakota gathering and processing acquisition.

NGL sales declined to 7,400 barrels per day in the first quarter from 8,600 last year. The decrease in sales volumes was largely driven by production declines in the Rockies, slightly offset by new volumes from the new North Dakota business.

Looking ahead, we are seeing improved drilling rates from producers on our gathering and processing footprint. In North Dakota, the current rig count is 51, up from 22 a year ago, with many of those rigs in our dedicated gathering acreage. This increased activity is driving new producer discussions around gathering investments as well as potential expansion of our new Bakken processing assets.

Shifting to Terminalling and Transportation. Segment operating income increased to \$98 million from \$63 million a year ago, and segment EBITDA grew to \$119 million from \$83 million last year. Terminalling throughput increased to slightly over 1 million barrels per day in the first quarter from 913,000 barrels per day last year. Volumes in our transportation business increased approximately 10,000 barrels per day to 834,000 barrels per day. The higher throughput was driven by increased activity around our California marine terminals as well as contributions from the acquisitions of the Northern California terminalling and storage assets that we completed in the fourth quarter of 2016 and the Alaska storage and terminalling assets completed in the third quarter of 2016.

We had a number of weather impacts in this segment during the quarter relating to extreme raining conditions across the West. During January, we saw lower volumes at our marketing terminals as significant rains slowed demand. Later in the quarter, we saw volumes on our Northwest Products Pipeline System in terminals slow as the outage of a key crude oil pipeline in the Salt Lake City refining complex caused a slowdown in refinery production. We're seeing normalized operating levels across the systems so far this quarter and do not expect any carryover effects of these first quarter issues.

Moving to our balance sheet, cash flow, capital expenditures and other financial metrics. In February, we successfully raised approximately \$284 million in gross proceeds from a public offering of 5 million common units. We used the proceeds to pay down our revolving credit facility and now have approximately \$1.6 billion of total availability. Net cash from operating activities for the first quarter increased to \$207 million from \$156 million last year, and distributable cash flow grew to \$152 million from \$142 million last year.

On April 19, we announced our first quarter distribution of \$0.94 per limited partner unit or \$3.76 per unit on an annualized basis, which was our 24th consecutive quarterly distribution increase. The declared distribution also represents a 16% year-over-year increase. Our distribution coverage was 1.09x for the quarter and 1.01x for the trailing 12-month period.

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Shifting to capital spending. In the first quarter, we spent \$30 million net of reimbursements. This includes \$20 million of growth capital and \$10 million of net maintenance capital. We continue to expect total 2017 net capital expenditures of \$295 million, including \$230 million of gross spending and \$65 million of net maintenance spending.

Looking ahead, you can find details of our volume expectations and other elements relating to our second quarter outlook in our earnings release issued yesterday.

With that, we'll take your questions. Hailey?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Jeremy Tonet with JPMorgan.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

I was just wondering, with the weather in the North Dakota as it was during the past quarter, if you might be able to provide a little bit more detail or quantify what the impact was on your business and how much -- what a normal run rate might look like if you had better weather there or normal weather?

Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

Yes. Jeremy, we haven't quantified the full number, but we saw a number of impacts in North Dakota with our new processing facility up at Robinson Lake that at one point, we could not clear NGLs from the rack and we had to slow down the facility for a period until that would clear. In the Rockies, we had a number of freeze-offs in our gas system that impacted our ability to get the gas into our processing facilities. And then as we detailed in the Terminalling and Transportation segment, we saw a significant number of unusual impacts to terminalling throughputs as well as pipeline throughputs during the quarter.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

That's helpful. Just thinking about the inventory of drop-downs upstairs, TSO, as it stands right now, premerger. I was wondering if you could refresh us as far as what the EBITDA stands for existing assets versus assets that could be constructed in the future? Just thinking about that drop-down inventory of what's currently in place?

Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

So as we've said in the past, our total inventory at Tesoro is approximately -- at least \$500 million of EBITDA. A portion of which is related to projects under development by Tesoro, but the majority of that \$500 million relates to existing assets and operations that Tesoro has now.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Got you, great. And then just going back to the comments with regards to 13D and just wondering what you might be able to say about that at this point, if that would impact the timing of drop-downs as that kind of get sorted out? Or is this just the framework as far as the IDR is being kind of collapsed in exchange for LP units? Or are there other avenues that could be pursued at this point?



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Steven M. Sterin - *Tesoro Logistics LP - CFO of Tesoro Logistics GP LLC, Principal Accounting Officer of Tesoro Logistics GP LLC, EVP of Tesoro Logistics GP LLC and Director of Tesoro Logistics GP LLC*

Jeremy, good morning. This is Steven Sterin. So, we'll be able to share a lot more over time that -- so I'll remind you of kind of our principles as we approach this. First, we want to continue to have an appropriate cost of capital and yield, distribution growth and coverage that allows TLLP to continue to grow, both through drop-downs as well as through organic growth and acquisition. And so that's really the key thing that we're solving for because we do see significant potential for continued growth within the business. As we think about that, there's a number of elements. You hit on a couple of them. The IDR's, the impact of that on the capital structure. We'll have 2 MLPs after we close the business, which will also enhance our drop-down inventory. And so we're going to be looking at all of that in a very expedient way. And so at this point, it's too early to tell you what that means in terms of timing around drop-downs or other things for the remainder of the year. But I can tell you that we've -- the reason we wanted to get moving on this is so that we can get through the process, do it well, do the proper reviews and governance. But to answer those questions as quickly as possible. So at that point, that's where we are. But keep in mind what we're trying to achieve.

Jeremy Bryan Tonet - *JP Morgan Chase & Co, Research Division - Senior Analyst*

Okay. Looking forward to more details there. And just one last one, as far as in the Rockies. Just wondering if you could update us as far as how many rigs are behind your systems? And kind of how do you think about the production trends there over time?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Sure, Jeremy. This is Phil. We've got 2 rigs operating in the Rockies presently: one, up in Pinedale; and one, in the Vermillion. The -- as would be the normal seasonal pattern, we did not hook up any of the winter wells here until the second quarter. So we're hooking up a number of ducts that have been drilled over the winter. And then, we are working with a couple of producers who are beginning to relook at the Utah areas to potentially bring drilling into that area. And that's -- that will be hopefully new development later this year.

Operator

Our next question comes from the line of Brian Zarahn with Mizuho.

Brian Joshua Zarahn - *Mizuho Securities USA Inc., Research Division - MD and Senior Analyst*

In the terminalling business in the first quarter, revenue per barrel had a good increase, both year-over-year and then versus the fourth quarter of last year. Was that a little bit higher due to weather? Or do you think those -- that, that revenue per barrel number is sustainable?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

So Brian, this is Phil. What would I tell you is it is sustainable and what it reflects is that the last couple of drop-downs have had a large storage component where we collect revenue based on a shell capacity of a tank, not throughput. And so it increases our revenue without really having a substantial increase in the denominator that we divide to get that number.

Brian Joshua Zarahn - *Mizuho Securities USA Inc., Research Division - MD and Senior Analyst*

And then looking at the North Dakota acquisition and understanding it's just one quarter seems to be on track. What was the EBITDA contribution approximately in the first quarter?



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Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Brian, we've not broken that out. If you look sequentially, though, 4Q '16 to 1Q '17, we increased EBITDA in the gathering and processing segment by \$25 million. And the moving pieces there are really the Rockies came down quarter-to-quarter as per normal seasonal volume trends. The new North Dakota assets contributed a substantial amount of the increase. And then we had a bit of organic growth as we mentioned in the commentary around our North Dakota pipeline system from higher throughputs there. So, those assets -- the North Dakota assets are performing in line with our expectations. Our outlook for the year remains in line and -- but the drilling activity that we see happening in place there, we do expect those assets to grow this year and into next year.

Brian Joshua Zarahn - *Mizuho Securities USA Inc., Research Division - MD and Senior Analyst*

That's helpful. I guess last one for me. Appreciate the high-level views on the potential restructuring. We'll stay tuned on those developments. I guess, looking ahead, maybe some high-level comments on opportunities you see in the Permian?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Sure. So we've obviously been looking in the Permian as we've commented for over a year. We've seen a couple of large crude oil systems transact extremely high multiples related to both of those. I think as remaining systems come on the market, we believe over the next year or so, we would like to be in position to execute around those types of transactions. And certainly, the actions that Steven detailed around getting Tesoro's balance sheet and capital structure in line to support potential significant investments is part of our strategy to support anything we might do down the road in the Permian.

Brian Joshua Zarahn - *Mizuho Securities USA Inc., Research Division - MD and Senior Analyst*

I guess do you anticipate looking ahead to be more organic given your likely footprint in the near future? Or would you leave a little more M&A to extend your footprint in the Permian?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

I think it's consistent with our strategy where we will always prioritize organic growth. And certainly, around the Western assets, we believe there's some very good opportunities to accelerate activity. And that will be our #1 priority, absolutely.

Operator

Our next question comes from the line of TJ Schultz with RBC Capital Markets.

TJ Schultz - *RBC Capital Markets, LLC, Research Division - Analyst*

Just one follow-up on the 13D. Is it your intention to have something to announce on the potential MLP combination and IDR plans at the same time as Tesoro closes the Western deal?

Steven M. Sterin - *Tesoro Logistics LP - CFO of Tesoro Logistics GP LLC, Principal Accounting Officer of Tesoro Logistics GP LLC, EVP of Tesoro Logistics GP LLC and Director of Tesoro Logistics GP LLC*

Hey, it's Steven, TJ. It's unlikely to be that precise for me to really call that timing. But I can tell you that we're going to work it as quickly as possible and that we've already started the process. And so we're not waiting to close to begin. And so as you can imagine, there's a lot of work that needs to take place with our conflicts committee and our store board level; and ultimately, with WNRL's conflicts committee. And so I'm not going to



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make a call on the timing, although, I'll tell you that we've done a substantial amount of work. And we're moving as fast as we can because it's very important to both TLLP, WNRL and Tesoro shareholders to position this business for the growth that's there. And we don't miss our opportunities to continue to grow and create all that value. And so we'll go as quickly as we can but doing it properly.

TJ Schultz - RBC Capital Markets, LLC, Research Division - Analyst

Okay, fair enough. Just on the crude gathered volumes. So you realized higher volumes in 1Q from the acquisition and some mine sale for DAPL. Guidance looks kind of flat into 2Q. So just any color on what may present additional growth from here as we think about your ability to connect third parties to High Plains or other organic initiatives?

Gregory J. Goff - Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC

Sure, TJ. In 2Q, we have really 2 dynamics. We continue to see volumes increasing from the standpoint of transiting our system to get to either DAPL or Enbridge or a couple of other regional takeaway areas. But during the second quarter, Tesoro's Mandan refinery is in turnaround for part of the quarter, which has a significant impact on our volumes. So I think if you took sort of 2Q third party demand coupled with a normal operating pattern around Tesoro's assets, you would see continued growth in that number.

TJ Schultz - RBC Capital Markets, LLC, Research Division - Analyst

Okay. For the growth CapEx, I know large piece is for the Los Angeles project and still waiting on that. But if you can just characterize where else the spend is focused? And as you mentioned, having more conversations with North Dakota GMP, if you see any shift in where you might spend organic capital? Or any ability to realize more than you maybe had thought initially on growth CapEx this year?

Gregory J. Goff - Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC

Sure. As -- when we look at the total spend of about \$230 million of growth capital, what I would tell you is the majority of that was in the Terminalling and Transportation segment. We continue to hold our [lyric] spending for this year -- sorry, the LA spending in line with our original plans, although, the permit timing could impact that. The balance of our spending was in the gathering and processing space where I think we will have a couple of new projects to approve in the relative near term. So relative to our overall portfolio for the year, we think we could see some shift in the gathering and processing ultimately driven by the timing around that LA permit.

TJ Schultz - RBC Capital Markets, LLC, Research Division - Analyst

Okay. The couple of new projects that you would have to announce in the near term, that's included in that \$230 million or is that incremental?

Gregory J. Goff - Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC

That would potentially be incremental. But as we evaluate overall the spending for the year, we'll wait until we sort of see the timing around the permit.

Operator

Our next question comes from the line of Gabriel Moreen with Bank of America Merrill Lynch.



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Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

I had most of my questions asked and answered. Just following up on TJ's in terms of the growth CapEx spend in the Bakken. Can you just speak to kind of where you are volumes versus capacity there on the processing side?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

The capacity -- or the High Plains capacity is really the sum of all of the outlets, and I'm not sure we even published a capacity number at this point. But we've continued to open up exit points to the Dakota Access Pipeline. We've added incremental connection to the BakkenLink pipeline that Tesoro holds that can now move bidirectionally. We continue to debottleneck our ability to get into the Enbridge system. So I think our -- theoretically, if we see production growth on the balance of 2017 and into 2018, I think we could pretty easily take the volumes on the system up over 300,000 a day, if we saw the demand.

Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

Got it, okay. And that's compared to the -- I'm sorry, was that on the barrels per day or on the million cubic feet?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Yes.

Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

Okay, got it.

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Sorry, that's barrels per day.

Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

Got it. And on the processing on the natural gas side, where you got, I think -- these 2 facilities you're acquiring at 170 million cubic feet a day. Just where you're running right now?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

We haven't broken out those numbers. But I would tell you, we're probably running about 80% roughly of the capacity on those facilities. The Robinson Lake facility, based on the discussions we've had with all of the existing customers, we could potentially see that facility reach its full operating capacity either later this year or early next year. And we are evaluating a number of opportunities to potentially expand the capacity of that plant as well as improve recoveries of NGLs out of the facility.

Gabriel Philip Moreen - *BofA Merrill Lynch, Research Division - MD*

And maybe this is a kind of basic higher-level question. But to what extent are you marketing production from any of these facilities? And do you just feel like you may or may not -- if you're not, do you feel like you would need a marketing arm to kind of help you grow in the area?



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Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

At this point, we are marketing the NGLs out of facilities. And we've actually turned over a couple of contracts and improved the terms already since we've owned the facilities. Tesoro has extensive commercial capabilities, and I think we would always look to leverage those broader capabilities in terms of improving the value that we would receive from those products.

Operator

Our next question comes from line of Corey Goldman with Jefferies.

Corey Benjamin Goldman - *Jefferies LLC, Research Division - Equity Analyst*

I just want to try and ask Brian's question a little bit differently on the North Dakota assets. Can you tell us the percentage contribution breakdown between the 2 segments there? Is that something that you can provide us?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

I really don't have that breakdown available. I think if you look at the guidance we gave you for the full year of EBITDA of \$100 million to \$110 million and we have a presumption of growth throughout this year where the first quarter landed in terms of volumes, certainly adjusted for a couple of plant slowdowns we had during the quarter, related either to weather or inspections. We're pretty pleased with where the first quarter landed as well as the prospects for growth for the balance of this year and hitting the numbers that we gave as guidance.

Corey Benjamin Goldman - *Jefferies LLC, Research Division - Equity Analyst*

Okay. No, that's helpful. And then maybe just as a -- my follow-up. Maybe this kind of goes back to your comments all about organic growth at TLLP. For -- on the TSO call, you guys had mentioned just a greater presence that you're looking at for -- in Mexico just given the attractive nature of now a deregulated market. So I guess on that point, are there any projects currently in the hopper at TLLP that you guys are considering that you may be able to share with us as it pertains to that market?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

I would tell you, initially, we've got a couple of small projects in our existing Southern California system that enable the movement of Mexican-grade gasoline out of a couple of our terminals. I think longer term as Tesoro pursues its strategy in Mexico and certainly some significant identified needs for infrastructure, there could very well be a role for Tesoro Logistics to play in the development of that infrastructure. Bottom line is that our guys are part of Tesoro's evaluation of that overall opportunity and where and when we want to make investments. So I think it's absolutely something we're looking at.

Corey Benjamin Goldman - *Jefferies LLC, Research Division - Equity Analyst*

Okay. And then maybe just as a follow-up to that. Anything that you could provide in terms of color on whether or not those projects would first be built at TSO and then dropped? Or do you think TLLP is of size and scale now that something that could true-up on their own?



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Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Corey, I think it's way too early to tell on that. We don't have a definitive list of what we would do. And I think as the Mexico business continues to develop, even in terms of rules and regulations, that's something we would have to take into serious consideration before we committed to spend capital out of TLLP.

Operator

Our next question comes from the line of Ryan Levine with Citi.

Ryan Michael Levine - *Citigroup Inc, Research Division - Equity Analyst*

Within the Permian, do you see any -- would you be able to provide any more detail around the organic CapEx opportunities that your platform may enable?

Phillip M. Anderson - *Tesoro Corporation - President of Tesoro Logistics GP*

Really, at this time, it would be inappropriate for us to go into too much detail. I mean, certainly, from our typical strategy prospective, we would look for opportunities that fit very well into a consolidated Tesoro value chain. And certainly, as production -- expectations of significant production growth across both the Delaware and the Midland basins and the ability to improve access either to the refinery and/or play a role on the gathering side, that would be our primary focus.

Ryan Michael Levine - *Citigroup Inc, Research Division - Equity Analyst*

Okay. And then regarding the potential transaction with the related MLP, if that were to be completed, what would be the review process with your credit rating agencies around a potential upgrade? Would it be something that could be triggered or reviewed immediately? Or is there a multi-month process?

Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

Yes, we've shared our plans and we continue to do so with the rating agencies. And we would like to get both Tesoro and TLLP to investment grade this year. Fitch already has both companies there. And to the extent the other 2 decide to move and the timing they decide to move, difficult to call. We'll be sharing with them our plans in terms around the capital structure and our financial discipline and coverage and leverage targets going forward. But the leverage targets that we've set of being below 4x, which is critical element of it, is unchanged. And so we think that the things that we're contemplating should only strengthen the position for both companies. And so we're cautiously optimistic that we could drive towards that this year. But whether that happens before we complete those transactions or after at the same time is, it's impossible to call. But that's -- we'd like to move quickly on that.

Ryan Michael Levine - *Citigroup Inc, Research Division - Equity Analyst*

Very helpful. And then last question for me around Mexico. So given that this open season was originally delayed and now Pemex selected Tesoro, do you envision or foresee more meaningful uptick in midstream opportunities within the country that could potentially benefit TLLP?

Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

So I think as we look at the results from the first open season and the tariffs being paid to utilize the existing assets. It certainly drives significant incentives for the development of new assets. I think from Tesoro's perspective and Tesoro's strategy, that Northwestern Mexico area is a key part



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of the Tesoro's long-term strategy. And to that extent, we'll look very hard at those types of investments. But it certainly sets it up with a significant incentive to pursue.

Operator

Our next question comes from line of Sunil Sibal with Seaport Global.

Sunil K. Sibal - *Seaport Global Securities LLC, Research Division - MD*

So a question related to the leverage metrics. Seems like you're running closer to 4.5x as of -- if I normalize what you did in the first quarter. I was wondering for any thoughts on the financing for the remainder of the year. Especially, it seems like to get to the \$1 billion EBITDA that you've guided, there will be an additional drop-down from here on?

Gregory J. Goff - *Tesoro Logistics LP - Chairman of Tesoro Logistics GP LLC and CEO of Tesoro Logistics GP LLC*

Yes. So when you look at our leverage, we look at it both in terms of trailing 12 months as well as pro forma. And we think that certainly, on a pro forma basis, because of all the activities that occurred at the end of last year, drop-downs and then at the very first part of this year around the acquisition that we can -- we see a way to get to 4x in a pro forma basis, which is what's looked at in this case this year. And so we've -- that's why we felt -- we feel comfortable that we're positioning the business to get to that point in 2017. And like I mentioned earlier, we'll provide more clarity on timing of drop-downs and how we would pay for those and structure those once we lay out the full capital structure strategy following the work that we still need to do around the potential merger in IDR.

Operator

Ladies and gentlemen, thank you for participating on today's conference. This does conclude the program and you may all disconnect. Everyone, have a wonderful day.

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