

THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TSO - Q3 2013 Tesoro Corporation Earnings Conference Call

EVENT DATE/TIME: NOVEMBER 07, 2013 / 1:30PM GMT

OVERVIEW:

TSO reported 3Q13 net income from continuing operations of \$64m or \$0.46 per diluted share.

Ex5585-000021-CRK



CORPORATE PARTICIPANTS

Brian Randecker *Tesoro Corp - Senior Director IR*

Greg Goff *Tesoro Corp - President & CEO*

Scott Spendlove *Tesoro Corp - SVP, CFO*

Dan Romasko *Tesoro Corp - EVP, Operations*

CONFERENCE CALL PARTICIPANTS

Jeff Dietert *Simmons & Company International - Analyst*

Doug Leggate *BofA Merrill Lynch - Analyst*

Paul Sankey *Deutsche Bank - Analyst*

Robert Kessler *Tudor, Pickering Holt & Co - Analyst*

Paul Cheng *Barclays Capital - Analyst*

Evan Calio *Morgan Stanley - Analyst*

Sam Margolin *Cowen and Company - Analyst*

Ed Westlake *Credit Suisse - Analyst*

Roger Read *Wells Fargo Securities - Analyst*

Matthew Blaire *Macquarie Research Equities - Analyst*

Mohit Patwa *Citigroup - Analyst*

PRESENTATION

Operator

Very good morning, ladies and gentlemen. Thank you all for joining. Welcome to the third-quarter 2013 Tesoro Corporation earnings conference call. My name is Lisa and I will be your coordinator for today. Today's conference is being recorded.

(Operator Instructions)

I would now like to turn the conference over to Mr. Brian Randecker, Senior Director of Investor Relations for opening remarks. Please, proceed. Thank you.

Brian Randecker - Tesoro Corp - Senior Director IR

Good morning, everyone, Welcome to today's conference call to discuss our third-quarter 2013 earnings. Joining me today are Gregg Goff, President and CEO; Dan Romasko, Executive Vice President of Operations; and Scott Spendlove, Senior Vice President and CFO.

While we will not be referencing slides during the call, we do have a set of slides which was filed with the SEC today. These slides, along with other financial disclosures and reconciliations for non-GAAP financial measures, should help you in analyzing our result and can be found on our website at www.tsocorp.com.



Please refer to the forward-looking statement in earnings slides, which says statements made during this call that referred to Management's expectations and/or future predictions are forward-looking statements intended to be covered by the Safe Harbor Provisions of the Securities Act, as there are many factors which can cause results to differ from our expectations.

With that, I'll turn the call over to Greg.

Greg Goff - *Tesoro Corp - President & CEO*

Thanks, Brian. Good morning and thanks for joining us on the call today. You have our earnings release and Scott will go over some of the details of the results in a moment, but I'm going to start with an overview of the highlights for the third quarter.

Despite a challenging margin environment during the quarter, we delivered net income of \$0.72 per diluted share. These results include earnings of \$0.26 per diluted share related to the sale and discontinued operation of our Hawaii business. Net earnings from continuing operations were \$0.46 per diluted share or \$0.44 excluding special items.

The Tesoro index in the third quarter averaged about \$8.50 per barrel down over \$8 per barrel relative to year ago, or about \$6.50 compared to the second quarter of this year. The Company's realized gross margin was \$9.22 per barrel for the quarter.

For the quarter, we reported strong utilization rates across all regions with total throughput in the quarter of 863,000 barrels per day or 102% utilization. The improved utilization and higher throughput drove manufacturing cost per barrel down to \$4.76 in the third quarter, a reduction of \$0.63 per barrel from the second quarter.

Retail fuel sales volumes were up over 120%, year over year, reflecting the addition of 835 high-volume ARCO retail gas stations as part of the Los Angeles Refining, Marketing and Logistics acquisition on June 1 of this year. Retail marketing margins were down relative to the same period last year. Same-store fuel sales during the quarter were up about 2%.

Our RINs cost were down in the third quarter, and we expect those costs to be immaterial in the fourth quarter. The lower RIN costs reflects both lower prices for RINs in the marketplace and benefits from the Los Angeles refinery acquisition, which has increased our capacity to blend renewable bio diesel.

Capital spending for the third quarter was \$123 million, turnaround spending was \$24 million. We anticipate full-year 2013 consolidated capital spending, including regulatory, maintenance and income projects, will now be about \$585 million, down from our previous guidance of \$690 million. We continue to expect \$400 million of turnaround spending for the full-year 2013. The remaining \$118 million of turnaround will be spent primarily on our California refineries during the fourth quarter.

We repurchased another \$100 million worth of Tesoro shares during the quarter. Through the end of October, we have purchased an additional \$38 million with the shares bringing total purchases to \$440 million or about 88% of the \$500 million authorization. Yesterday, the Board of Directors increased the existing \$500 million share repurchase program to \$1 billion, and declared a regular quarterly dividend of \$0.25 per share, further demonstrating our commitment to financial discipline and returning value to our shareholders.

We ended the third quarter with nearly \$1.5 billion of cash, a buildup of over \$1 billion during the quarter. Most of the build was driven by proceeds from the sale of the Hawaii business and reductions in working capital. Subsequent to the end of the third quarter, we repaid \$500 million of the \$1.2 billion of interim borrowings used to fund the Los Angeles acquisition, taking Tesoro's leverage, excluding Tesoro Logistics, to 31% pro forma for September 30.

The activities and results of the third quarter truly reflect our commitment to our strategic priorities. The sale of the Hawaii business to Hawaii Pacific Energy, a wholly-owned subsidiary of Par Petroleum, was a strategic exit from low-return assets in Hawaii. With the sale, we have effectively reallocated \$325 million of net working capital to the higher return and more strategic Los Angeles assets.

We continue to pursue opportunities to increase our capacity to run advantage crude oil throughout our system and we realized continued improvements there in the third quarter as well. We delivered approximately 50,000 barrels per day of Bakken crude oil to our Anacortes, Washington refinery to the Tesoro Logistics rail-offloading facility.

We also started taking up to 3 unit trains a month of Bakken crude oil into our Martinez refinery through a third-party facility, adding to the manifest rail cars we've already been delivering to that refinery. With the addition of these unit trains we have the capacity to deliver nearly 350,000 barrels per month of Bakken crude oil into our Martinez, California refinery.

Our joint venture with Savage, to build a 280,000 barrel per day rail-offloading facility at the Port of Vancouver, Washington has moved into the permitting phase with applications for environmental permits being submitted in August. We continue to expect that facility to be up and operational sometime late next year, or early in 2015, and intend to offer it for sale to Tesoro Logistics, LP.

In Salt Lake City, after completing the first stage of the conversion project in the second quarter this year and ramping up production over the third quarter, we now expect to run an average of 17,000 barrels per day of cost advantage waxy-crude oil from the Uinta basin during the fourth quarter.

We optimized the timing of bringing this project online with a turnaround plan, and Phase II of this project is now expected to be completed during the end of the first quarter to the beginning of the second quarter of 2015. Taking total runs of the cost advantage waxy-crude oil to 22,000 barrels per day, increasing our total throughput capacity by 4,000 barrels per day and improving overall clean-product yields. There is no change to prior estimates of the total project EBITDA of \$100 million per year or the total cost of \$275 million.

On the clean product side, we also enjoyed the first full quarter's contribution from expansion of the diesel desulfurization unit at our Mandan refinery, increasing our ability to produce additional higher-valued products. The expansion allowed us to increase overall throughput rates at the refinery and distillate production increased by over 25% compared to the second quarter of 2013. This project has performed better than our expectations during the third quarter as evidenced by the strong capture rate reported in our Mid-Continent region.

Turning to the recent acquisition of the integrated Los Angeles Refining, Marketing and Logistics business, we are extremely pleased with the operating performance of the Los Angeles refinery and the integration is going very well. The synergies we anticipated prior to close appear to be even greater than we originally thought. We plan on providing a full update of our expectations for synergy sources, amounts and timing at our analyst day meeting in New York on December 10.

We continue to progress the sale of nearly all of the remaining Logistics assets at Los Angeles to TLLP and now expect the value of those assets to sell in the range of \$600 million to \$700 million. Combined with the proceeds of \$640 million from the initial sale of Logistics assets, the second sale will take total proceeds to almost \$1.3 billion, more than the \$1.1 billion we paid for the Refining, Marketing and Logistics assets of the close on June 1.

We expect to use some of the proceeds to further reduce debt and drive leverage back down under 30% returning our balance sheet to the same position and strength we enjoyed prior to the Los Angeles acquisition and doing so in less than a year after closing. Using TLLP's lower cost of capital to fund more than half the Los Angeles acquisition drives value to our Tesoro shareholders.

You can see, from all we've done this year, that we are driving significant value from our existing asset base and optimizing our portfolio of assets. We continue to look for and identify new ways to grow the value of our business. Before I turn the call over to Scott, let me comment briefly on Tesoro Logistics High Plains Pipeline incident in North Dakota.

TLLP reported that Tesoro High Plains Pipeline experienced an approximate 20,000-barrel release of crude oil in a rural filled northeast of Tioga, North Dakota. TLLP recently restarted that section of the pipeline and continues to work with the landowner, regulators, local state and federal government officials to remediate the site and investigate the incident. The incident did not impact crude oil supply to our Mandan or Anacortes refineries.



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

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Thanks, Greg. As we reported last night third-quarter net income from continuing operations was \$64 million, or \$0.46 per diluted share. Adjusted for special items, we reported an adjusted net income from continuing operations of \$60 million, or \$0.44 per diluted share.

Special items we excluded from the quarterly results include after-tax net income of \$0.14 per diluted share, related to the reversal of a legal reserve around Alaska pipeline tariffs and proceeds from business interruption insurance in Anacortes. Expenses of about \$0.12 per diluted share, related to integration costs and a non-cash inventory valuation adjustment, related to the two acquisitions we closed during the second quarter. That compares to net income from continuing operations in the third quarter last year of \$259 million, or \$1.82 per diluted share.

Our corporate and unallocated cost for the third quarter of 2013 on a pretax basis were \$52 million, before \$6 million in corporate depreciation, and excluding a benefit of \$21 million in non-cash, stock-based compensation, and \$14 million of integration costs that I just mentioned.

We ended the quarter with a cash balance of about \$1.5 billion, an increase of \$1.1 billion for the quarter. Sources of cash included adjusted EBITDA of about \$308 million, changes in working capital of \$531 million and proceeds of \$514 million for the sale of our Hawaii operations.

The changes in working capital were primarily related to the Los Angeles acquisition offsetting the significant use of working capital we experienced in the second quarter, related to the acquisition of the timing of cargo payment and receipts worked through our cash conversion cycle. Uses of cash included capital and turnaround spending of about \$150 million in the quarter, shareholder distributions and share buybacks of \$150 million, and cash interest and taxes of about \$15 million.

At the end of the third quarter, we had additional revolving credit capacity of about \$1.5 billion on the corporate revolver and \$575 million on the Tesoro Logistics' revolver. Tesoro's total debt to total capitalization, excluding Tesoro Logistics debt, at the end of the third quarter was 36%. Subsequent to the end of the third quarter the Company repaid \$500 million of the \$1.2 billion of short-term borrowings related to the Los Angeles acquisition.

We now have approximately \$2 billion available on our revolving credit facility post this debt reduction. Following the debt repayment, total Tesoro debt was \$1.97 billion, or approximately 31% of total capitalization pro forma for the end of the third-quarter 2013. Tesoro Logistics debt totaled \$909 million of the end of the third quarter.

Turning to the fourth quarter and guidance, we estimate throughput to be in thousands of barrels per day, 480 to 500 in the California region, 155 to 165 in the Pacific Northwest, and 120 to 130 in the Mid-Continent. Manufacturing cost guidance for this quarter in dollars per barrel is as follows. \$6.00 to \$6.25 in the California region; \$4 to \$4.25 in the Pacific Northwest; and \$3.60 to \$3.85 in the Mid-Continent. Our depreciation for refining is estimated at \$120 million going forward.

Additional fourth-quarter guidance items include estimated corporate expense, excluding depreciation of \$72 million and interest expense before interest income of \$44 million. Our corporate expense guidance includes the impact of integration costs as well as some one-time restructuring costs. Our expected quarterly run rate for corporate expense is in the range of \$55 million to \$60 million going forward.

With that, all turn the call back over to Greg for closing comments. Greg?

Greg Goff - *Tesoro Corp - President & CEO*

Thanks, Scott. We are pleased with the progress of several of our major initiatives. Additionally, with the \$500 million in debt reductions previously discussed and the sale of the majority of the remaining Los Angeles Logistics assets to TLLP, we look forward to returning Tesoro's balance sheet to the same, strong position as prior to the Los Angeles acquisition.

We remain focused on our strategic priority of financial discipline and will continue to prioritize investing in high-return capital projects, returning cash to shareholders via a strong and competitive dividend, buying back shares and delevering our balance sheet. We look forward to further updating you in December at our Analyst Day around the progress of the Los Angeles acquisition and related synergies.

With that, Dan, Scott and I will now take your questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

John Dietert, Simmons.

Jeff Dietert - *Simmons & Company International - Analyst*

Jeff Dietert with Simmons. I think it was reported that Trans Mountain had some flow reductions during 3Q that may have impacted your syn crude deliveries at Anacortes. Could you talk about what level of syn-crude interruption you saw in 3Q, and remind us what that potential is at Anacortes for 4Q?

Greg Goff - *Tesoro Corp - President & CEO*

Yes, Dan, why don't you address that question, please?

Dan Romasko - *Tesoro Corp - EVP, Operations*

Jeff, we're similar to all the shippers on Trans Mountain and we previously discussed our Canadian shipments in the 30% to 40% range and we're at the bottom end of that range now. Third quarter did see an impact with that. We'll still near the bottom of that range for the fourth quarter, potentially a bit better.

Jeff Dietert - *Simmons & Company International - Analyst*

So, that outage is continuing through 4Q?

Dan Romasko - *Tesoro Corp - EVP, Operations*

It's not so much an outage as it's overall pressure restriction, and, yes, it's continuing.



Jeff Dietert - *Simmons & Company International - Analyst*

Secondly, ANS pricing has softened a bit. It's still, for a medium, sour crude, trading well above LLS and WTI and some other light crudes in the US. With the incremental Bakken moving by rail to the Pacific Northwest and California, how do you see ANS pricing evolving over time? Do you see it shifting towards something more similar to its quality?

Greg Goff - *Tesoro Corp - President & CEO*

It's a good question, Jeff, I think our believe is that as we continue our efforts to move more of the crudes from the Mid-Continent out to the West Coast, ANS will price more competitively relative to those crudes, which will put downward pressure on it.

Jeff Dietert - *Simmons & Company International - Analyst*

Based on ANS's quality, what kind of incremental detriment do you think is possible?

Greg Goff - *Tesoro Corp - President & CEO*

What we can see and what we have said in the past the least relative to Anacortes is that our yield advantage at Anacortes, running Bakken crude, relative to ANS is in the \$3 to \$5 per barrel range. That's our specific refinery.

Jeff Dietert - *Simmons & Company International - Analyst*

Got you. Thanks for your comments.

Operator

Doug Leggate, Bank of America, Merrill Lynch.

Doug Leggate - *BofA Merrill Lynch - Analyst*

I wonder if I could just hit a couple of things? On the West Coast, obviously, we had a bit of a sloppy market in third-quarter. Our understanding, anyway, is that a bunch of refineries were running extremely well, yourselves included. How are things looking in your respect as you look forward over the next 3 to 6 months? Obviously, I don't expect you to give specifics on competitor downtime, but is what we saw in Q3 in your mind unusual? And if so, would you expect to see that for want of a better words, sloppiness tighten up a little bit? I'm curious about any change in the export dynamics from the product side you're seeing on the West Coast? I've got a follow-up, please.

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Yes, Doug, let me take that. I'll start with export market. If you've looked at the EIA data, which you probably have, you'd noticed that so far in the third quarter the data would show that we're about 200,000 barrels a day export off of the West Coast, which is about 80,000 barrels a day higher than we've seen historically. We've not provided specific guidance on the level of participation from Tesoro, but we are a participant in that market. As far as the level of run rates in the West Coast during the third quarter and whether that's unusual, I think relative to the last few years it clearly has been unusual. We continue to run well and expect to do so for the next several quarters. The good news is that we've got a strong marketing integration to place our product into the market. You saw that show up in a strong marketing performance for the third quarter.

Doug Leggate - *BofA Merrill Lynch - Analyst*

Great, I appreciate that. My follow up, I guess it's another big picture question. Yesterday, we heard Holly talk about the risk of product pricing in the Mid-Continent start to move toward LLS. I'm not sure I'm entirely convinced by that risk, as they followed that later on last night by saying that there's no evidence of product moving into that market. I'm just curious if you could give your perspectives we see Gulf Coast crude advantage really start to widen out here? How do you see the risk of product box up into what's been a very advantage market for you guys? I'll leave it at that, thanks.

Greg Goff - *Tesoro Corp - President & CEO*

Doug, our view has been that product prices would price relative to Brent as you look at the global system of being able to move products around the world and that Brent would set the pricing for that. I guess it is possible that in local markets that you could see times when that doesn't reflect it because of being inland or that, but we've tended to believe the prices will still price off of Brent for products.

Doug Leggate - *BofA Merrill Lynch - Analyst*

That's our view as well. Thanks a lot, appreciate it.

Operator

Paul Sankey, Deutsche Bank.

Paul Sankey - *Deutsche Bank - Analyst*

Could you just, to the extent that your prepared to do that, talk a little bit more about the synergy wins that you are having in California? Could you talk about where that's going to leave you on the cost curve? And in that context, could you talk about how you see the California market developing from here? Finally, could you talk about how much of the current extreme discounts in the Bakken that you're going to be seen through your system, given that we're so different today than we were in Q3? Thanks, Greg.

Greg Goff - *Tesoro Corp - President & CEO*

Paul, back on California, we're about a month away from being able to give a very clear picture of what we will deliver in California as a result of acquisition, but maybe just a few preliminary comments. One is that we have reinforced our initial view that the synergies that we originally thought are absolutely there. We're excited that actually as we've got more into it that potential opportunity is greater than what we'd thought. We'll go over all the details of that, so that, to us, is very encouraging. If you look at what we said all along, the synergies, relative to EBITDA of the business based upon our analysis using 2011 as a year, were pretty significant. When we come out and share more of that, I think everyone will be -- when we can be more clear about what they are, we'll see the real value of the acquisition.

The second thing is that as part of those synergies, we are going to have an opportunity to further improve our cost structure in California, which we'll layout in December, also, which will be added further advantage to our system in California. To be honest with you, it's all very, very good news. The last thing you asked about, kind of the overall marketplace in California. When we looked at making this acquisition back in 2012, the margins, the gross margins using the LA crack spread for California had been relatively stable. Our projections were that it would stay that way on a go-forward basis. Since that time the economy and things have improved out there and the fundamentals have gotten a little bit better. We're pretty confident, with the level of where we made the acquisition, will continue to be a good basis for the crack spread. The more important thing is that all the synergies and benefits that we'll drive, we believe, will be additive to the value capture, and we'll show that in December.



Regarding Bakken, the Bakken prices have been very, very attractive and we'll capture that benefit in the fourth quarter. You can see what they've been, what's published in the market and that, and it's been a very attractive differential so far. Our Mandan refinery is running 100%. We're taking quantities of Bakken to Anacortes like we said in the comments here, so we'll reap those benefits.

Paul Sankey - *Deutsche Bank - Analyst*

Thanks, Greg. Obviously the Bakken differential is essentially related to early supply?

Greg Goff - *Tesoro Corp - President & CEO*

Right.

Paul Sankey - *Deutsche Bank - Analyst*

Thanks.

Operator

Robert Kessler, Tudor Pickering Holt.

Robert Kessler - *Tudor, Pickering Holt & Co - Analyst*

I wanted to see if you could specify a little bit the change in CapEx and what that relates to? I think you bumped it up last quarter, in part on the Carson deal and now it's come back down. Is that just simple timing around the expenditures there?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Yes, maybe I'll take that one. We did find opportunities to both reduce capital spending as well as shift some of it into future period where it was more efficient to spend. Obviously, in hindsight, that would've been better to have had that information where when we were communicating at the end of the second quarter, but nevertheless, it's a good news story for us. Both of those, and the moves on the capital both elimination and the deferrals, were done in a manner that don't impact reliability or EBITDA generation.

Robert Kessler - *Tudor, Pickering Holt & Co - Analyst*

Okay, thanks for that. On Port of Vancouver, if I'm detecting a slight slippage in timing, you're now throwing out the possibility of an early 2015 start. Is that just simple delays related to permitting, or anything else going on there?

Greg Goff - *Tesoro Corp - President & CEO*

The permitting process in the state of Washington, we believe, is going to be pretty firm around about a one-year period of time. Originally where we thought maybe we'd be able to pick up a little bit a time, because of our experience at Anacortes, we're not as confident that we can gain any time during that one year period. As we stated earlier, we submitted all of the permits in August and we expect that to take until about August of 2014. Then, the construction time to build the tanks and that, we're going to work as hard as we can to come up at the end of 2014, but we had that window with late 2014, early 2015.



Robert Kessler - *Tudor, Pickering Holt & Co - Analyst*

Thanks. Have you decided how much of the tankage will be a heavier barrel capability versus light and on a general split on throughput volumes for say a Canadian heavy barrel coming through as opposed to Bakken?

Greg Goff - *Tesoro Corp - President & CEO*

The facility is an ideal facility with great efficiency, the environmental standards and that, and we'll have tremendous flexibility to deliver the types of crudes that the marketplace needs as we go in there, both from a Tesoro standpoint, since we've already made a commitment to it but also to the other customers by using the facility. We'll be very flexible.

Robert Kessler - *Tudor, Pickering Holt & Co - Analyst*

You've got some good numbers as far as the rail costs by comp coming over from the Bakken to Anacortes. What about the Canadian heavy rail cost? Any thoughts for what it cost to come down from Alberta?

Greg Goff - *Tesoro Corp - President & CEO*

No, not at this time.

Robert Kessler - *Tudor, Pickering Holt & Co - Analyst*

Okay, thanks, anyway.

Operator

Paul Cheng, Barclays.

Paul Cheng - *Barclays Capital - Analyst*

First question, Scott, the working capital benefit from Carson, I presume is on the inventory payable that now you start to deal with. Is that pretty much done? Or, that we have more room for the payable on the crude to go up and become a source of funding in the fourth quarter?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

No, that's pretty well done now, Paul.

Paul Cheng - *Barclays Capital - Analyst*

That's done, okay. Just want to, I think that I know the answer, but just want to make sure. When we're looking at your Tesoro Index your Pacific Northwest, is that only based on ANS or that's also building in to either Bakken or the Canadian light sweet?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Maybe I'll take that one, Paul. It's based on about one-third WTI and two-thirds ANS.



Paul Cheng - Barclays Capital - Analyst

So, that means that, given the Canadian light sweet to WTI discount have widened, probably by call it \$8 to \$10 versus the third quarter level. So, that, by itself would suggest that the Pacific Northwest probably understate or that the capture rate will be increased by quite a substantial amount of dollar per barrel? Also that this is not -- you haven't factored in into any Bakken? Bakken to ANS looks like it's improved by about \$9 to \$10?

Scott Spendlove - Tesoro Corp - SVP, CFO

Both of those are correct.

Paul Cheng - Barclays Capital - Analyst

Okay. In the Mid-Continent, I believe you are just using the WTI, right?

Scott Spendlove - Tesoro Corp - SVP, CFO

Yes.

Paul Cheng - Barclays Capital - Analyst

The degree that Bakken to WTI or Wyoming sweet to WTI, both of them have increased by somewhere in the \$5 to \$6 that we should see a pretty substantial improvement in terms of that capture rate?

Scott Spendlove - Tesoro Corp - SVP, CFO

That is also correct.

Paul Cheng - Barclays Capital - Analyst

Okay. Is there anything in the fourth quarter that we should be aware that not allowing you to capture that?

Scott Spendlove - Tesoro Corp - SVP, CFO

Not in the Mid-Continent, nor in the Pacific Northwest.

Paul Cheng - Barclays Capital - Analyst

Okay. When you buy Bakken, do you buy it as a spot? Or, do you buy it one month out?

Scott Spendlove - Tesoro Corp - SVP, CFO

I'm sorry, I didn't understand the question?



Paul Cheng - Barclays Capital - Analyst

When you purchase Bakken, should we look at it as a spot price or that it would be a delivery amount and that is one month out?

Scott Spendlove - Tesoro Corp - SVP, CFO

It's a mix. We do have a trade purchase month impact in the DC and the pricing, so you do see some of that. Our actually pricing practices are a mix.

Paul Cheng - Barclays Capital - Analyst

Okay. This is, I think, for Greg. Greg, I have to apologize, you went through your say you are now running, you have the capability to have three unit train a month to Golden Eagle, and you're saying that that will give you say 350,000 barrels per day? Or, did I probably catch that number wrong. Can you just repeat for me?

Greg Goff - Tesoro Corp - President & CEO

Right. Yes, Paul, what we said was we can deliver three unit trains per month into the Martinez or Golden Eagle refinery as well as some additional manifest cars that we do, which allows us to maximize the use of the facilities. As a result of that, it's 350,000 barrels per month at the present time.

Paul Cheng - Barclays Capital - Analyst

Okay, 350,000 barrels per month.

Greg Goff - Tesoro Corp - President & CEO

Yes, that's correct.

Paul Cheng - Barclays Capital - Analyst

Can you tell us that what was the Bakken oil you run in Golden Eagle in the third quarter and what is the expectation in the fourth quarter?

Greg Goff - Tesoro Corp - President & CEO

The Bakken Eagle at Golden Eagle, Paul, actually your conference, is the first time we took our first unit train in was the day of your conference in September. It really just started and is just ramping up. So, I think, looking forward, that level of crude supply, the 350,000 is a good number to use.

Paul Cheng - Barclays Capital - Analyst

Okay.

Greg Goff - Tesoro Corp - President & CEO

Per month.



Paul Cheng - *Barclays Capital - Analyst*

I apologize if you already said that, when do you expect the second Carson offset drop-down to happen?

Greg Goff - *Tesoro Corp - President & CEO*

We haven't stated. All along we've said that we would do it within the first year, but we're making very good progress to do the second drop-down.

Paul Cheng - *Barclays Capital - Analyst*

Okay. A final one in Carson, can you tell us that what is your crude slate? Is there any change already?

Greg Goff - *Tesoro Corp - President & CEO*

The crude slate, it's only been a few months and so the crude slate has stayed relatively comparable. We are doing a little bit of crude substitution from what we originally started, but nothing material at this point in time as we still continue to work through our future crude supply.

Paul Cheng - *Barclays Capital - Analyst*

Do you have a preliminary budget for 2014 given that you have shift some of the money in 2013? For CapEx or OpEx?

Greg Goff - *Tesoro Corp - President & CEO*

Our capital budget, Paul, we're less than a month away and we'll be very clear about what we plan to do for 2014. So, let's just wait till we get there and will go over the capital budget and turnaround budget as part of our presentation at that point in time.

Paul Cheng - *Barclays Capital - Analyst*

Thank you.

Operator

Evan Calio, Morgan Stanley.

Evan Calio - *Morgan Stanley - Analyst*

A lot of ground already covered there. Maybe just a quick follow up on the West Coast market commentary, Greg. Given the forecast for lower plant turns and Richmond back online in 2014, do you expect to need to see increased West Coast exports to clear the market? Or, are you more -- maybe optimistic or on demand or pessimistic on run rate? Any thoughts there would be helpful? Thanks.

Greg Goff - *Tesoro Corp - President & CEO*

I think relative to exports, Dan framed up the exports when he stated that they were actually stronger than they had been for some time, there for a while. Our view is that the exports off the West Coast have limited markets that they can reach relative to like the Gulf Coast. So, the range that we've seen on exports off the West Coast, we expect to stay in that range and we don't see any substantial changes to the exports off of there. The West Coast market, in general, if you look at where just using the LA crack spread as kind of a benchmark of where the markets. I mean the crack



spread has stayed reasonably good in LA, so far. So far in October it was \$14.50. Month to date it's a little over \$14, and in that \$14 range for a crack spread for LA is not a bad crack spread. That's relative to ANS and we'll see what happens to ANS prices. That's one of the prior questions asked on a go-forward basis. Our view is that the fundamentals in California are improving a little bit from what they were earlier from a demand standpoint and that, and that we'll just see how the market shapes up.

Evan Calio - *Morgan Stanley - Analyst*

Can you comment if you were off-line at all in October in Los Angeles?

Greg Goff - *Tesoro Corp - President & CEO*

In my comments earlier I did state that we are spending about a little over \$100 million on doing turnaround work in the state of California during the fourth quarter. So, we do have downtime in California, yes.

Evan Calio - *Morgan Stanley - Analyst*

Got it, appreciate it.

Operator

Sam Margolin, Cowen & Company.

Sam Margolin - *Cowen and Company - Analyst*

A lot of stuff has been gone over. I just want to circle back to that DDU in Mandan because it looks like it really made a pretty significant impact. Is there anything you could share with respect to contribution or break it out a little bit? The outperformance in that region is pretty stark compared to others who have reported already.

Greg Goff - *Tesoro Corp - President & CEO*

Yes, let Dan make some comments on that.

Sam Margolin - *Cowen and Company - Analyst*

Sure.

Dan Romasko - *Tesoro Corp - EVP, Operations*

Maybe the simplest way to do that calculation is look at the gasoline-diesel differential on approximately 4,000 to 5,000 barrels a day. A swing we made between those two products. Independent upon what the market is in your forecast of where it's going to be you can get a good view of what the economics were.

Sam Margolin - *Cowen and Company - Analyst*

Okay. It's all, I'm assuming, it's all sort of local diesel demand just from the other energy patch around area? Or?



Dan Romasko - *Tesoro Corp - EVP, Operations*

Yes, that's mostly true. The short in North Dakota on diesel is pretty significant, and we're really quite close to where the demand is. We actually sell the vast majority of our diesel out of the Mandan area. Export very little out of the state.

Sam Margolin - *Cowen and Company - Analyst*

Got you. Forgive me if I missed this, but we talked about Bakken differentials expanding pretty meaningfully here. Have you guys made a determination about the expansion at the Vancouver rail terminal? Or, are we still thinking about the 125,000 barrels a day? For the first days?

Greg Goff - *Tesoro Corp - President & CEO*

Yes, Sam. The facility will be permitted to run up to the 280,000 barrels a day or so that we've set. We haven't gone to the market to make access of that available to other parties yet, but we'll make a determination of what that capacity will be at the facility when we bring it online. There's not a lot of work to do to get it up to the 280,000 barrels a day, so we'll see what the market demand is and make that decision accordingly.

Sam Margolin - *Cowen and Company - Analyst*

All right, great. Thanks so much.

Operator

Ed Westlake, Credit Suisse.

Ed Westlake - *Credit Suisse - Analyst*

Just some questions on the drop-downs. I think you said \$600 million to \$700 million more from the cost on acquisition? Did I hear that correct?

Greg Goff - *Tesoro Corp - President & CEO*

Yes, you did. That's correct.

Ed Westlake - *Credit Suisse - Analyst*

Great. Then, you've got, obviously, the potential in the Pacific Northwest, as those assets get to a point where they can be drop-down. Outside of those two main sources of drop-downs, can you just remind us what else potentially could be drop-down into an MLP over time?

Greg Goff - *Tesoro Corp - President & CEO*

We have a fair amount of other assets that we've identified that we will be able to drop-down over time and we haven't gone out and put values on those assets and that. Throughout our system actually, there's a fair amount of additional drop-down activity yet that we'll be doing over the next 2 or 3 years.



Ed Westlake - *Credit Suisse - Analyst*

I think you may have said this, but on working capital you feel you've done most of the adjustments in terms of free net working capital at this point from a balance sheet perspective?

Greg Goff - *Tesoro Corp - President & CEO*

Scott answered the question relative to Carson. As we work to the cash conversion cycle and that, we feel a lot better now after the initial acquisition and where we've gone as its stabilized now. We feel pretty good pending any changes in crude slate that we may be do in the future, which could change it again.

Ed Westlake - *Credit Suisse - Analyst*

Obviously the balance sheet gets delevered and you've been signaled on dividends and buybacks, but --

Greg Goff - *Tesoro Corp - President & CEO*

Yes.

Ed Westlake - *Credit Suisse - Analyst*

I guess we'll get an update once the balance sheet comes back. Is there any thought process here to be even more aggressive on the buyback?

Greg Goff - *Tesoro Corp - President & CEO*

We'll continue to follow our approach that we've used for the last few years here. That's we'll continue to identify high-return capital projects that strengthen our competitive positions in the market and allocate capital to those projects. We will continue to maintain a competitive dividend relative to our peers. We will also look to get our -- we've always targeted to be less than 30% leverage in our balance sheet and we'll my continued to be focused on that. Finally, we will then return cash to shareholders.

Ed Westlake - *Credit Suisse - Analyst*

Okay. Then, a final smaller one just on California. Obviously, really strong volumes in the third quarter and you given guidance 480 to 500. You mentioned some turnarounds, but is there any volume upward bias in terms of the cost in asset that perhaps we're not picking up? Or is it just the turnaround activity that's causing the drop and 557 is a more peak type third-quarter activity level?

Dan Romasko - *Tesoro Corp - EVP, Operations*

Let me take that one. Third quarter is an example of a full run rate for the California assets and what you're seeing in the fourth quarter is, on the rate reduction, is turnaround related.

Ed Westlake - *Credit Suisse - Analyst*

Right. Any debottlenecking potential that you've identified since, or will that be a subject for the December analyst meeting?

Dan Romasko - *Tesoro Corp - EVP, Operations*

That will be a subject for the December analyst meeting although that would be contrary to what we've discussed before on synergy. Our view is really driven towards yield optimization, cost improvements, those opportunities.

Ed Westlake - *Credit Suisse - Analyst*

Okay, clear. Thanks very much.

Operator

Roger Read, Wells Fargo.

Roger Read - *Wells Fargo Securities - Analyst*

Maybe a couple of things that haven't been pounded on just yet. Number one, exports, anything new to report there? Then, as you think about maybe bringing more of the Bakken barrels either by manifest delivery now or once you get Port of Vancouver up and running, where you think some of those volumes could go?

Greg Goff - *Tesoro Corp - President & CEO*

The exports, just to restate the comments on exports, is the exports of the West Coast continue to be strong. They were particularly strong during the third quarter, like Dan mentioned earlier. Like we have always said is that, and exports are part of how we manage our system on the West Coast and that. We continue to be a participant in the export market and as we look forward we don't see any real changes in that export activity. It looks promising. Regarding the ability to move Mid-Continent crude oil to the West Coast, and we're continuing to work on doing that. Throughout our whole refinery system on the West Coast we have the capability to run additional Bakken crude oils, probably with the exception of the Wilmington part of the Los Angeles refinery. Now, that we combined the two facilities into one, that is a heavy crude processing refinery. Across the whole West Coast system from the Carson facility all the way to Kenai we can run additional Bakken crude oil.

Roger Read - *Wells Fargo Securities - Analyst*

Maybe a slightly more specific way to ask the question. Earlier, you mentioned that you get a definite uplift, \$3 to \$5 a barrel, in Anacortes when you run the Bakken barrel.

Greg Goff - *Tesoro Corp - President & CEO*

On yield.

Roger Read - *Wells Fargo Securities - Analyst*

I'm sorry, yield. It obviously makes it a more competitive unit. Are you seeing that in California and should we think about that is making those units more competitive in terms of export potential? Or, just in the sense of fighting on imports into the region and keeping you more consistently profitable?



Greg Goff - *Tesoro Corp - President & CEO*

We'll see opportunities to get enhanced yield benefits by running the Bakken crude relative to the other crudes that we run on the West Coast. That's accurate.

Roger Read - *Wells Fargo Securities - Analyst*

Would it be as dramatic as what you see in Anacortes or not, given the complexity of those units?

Greg Goff - *Tesoro Corp - President & CEO*

Anacortes is probably like the best case, but it's going to be in the ballpark.

Roger Read - *Wells Fargo Securities - Analyst*

My follow-up question on the CapEx commentary. Obviously, the deferrals out of 2014, lowering the CapEx, should we think about as a preliminary thought process 2015 has to include that? So, we're probably thinking of the old 2014 number being more like a reasonable expectation for 2015? I know you're not in the process of giving a firm number, but, just in general, trying to think about future numbers?

Greg Goff - *Tesoro Corp - President & CEO*

First, let me just clarify. We moved capital out of 2013 into 2014. The best thing to do is, when we come out in December, we can -- you get a very clear picture of what are capital requirements are for both our sustaining capital, which is our regulatory and maintenance, and also our income capital, which will tie in with what we're trying to do in California and that. It will all fit together when we talked about in December.

Roger Read - *Wells Fargo Securities - Analyst*

Okay, thank you.

Operator

(Operator Instructions)

Matthew Blair, Macquarie.

Matthew Blaire - *Macquarie Research Equities - Analyst*

On the three unit trains a month to Martinez, just curious with the limiting factor is here? Do you have the ability to ramp this up, going forward?

Greg Goff - *Tesoro Corp - President & CEO*

The limiting factor is just the overall delivery system. We use a third-party facility and it's pretty much maxed out at that rate by the way that we have to get the crude into the facility. This was the way, on an interim basis until we get Port of Vancouver running, to deliver Bakken crude oil into northern California.



Matthew Blaire - *Macquarie Research Equities - Analyst*

Okay, thanks. Then, I think as part of the Carson deal you plan to sell some excess real estate? Did that occur in the third quarter? What were the proceeds there?

Greg Goff - *Tesoro Corp - President & CEO*

Some of that real estate was sold prior to the actual closing because the closing took longer than we'd anticipated. There is a small amount of remaining real estate that we haven't determined what will do yet, so it's a little bit of both.

Matthew Blaire - *Macquarie Research Equities - Analyst*

Okay. Finally, just on the Port of Vancouver rail terminal, are you in the process of acquiring new rail cars for this facility? Could you just give some comments there? Thanks.

Greg Goff - *Tesoro Corp - President & CEO*

We balance our needs for our delivery system with rail cars and we have made commitments to receive some additional rail cars to meet our requirements, both into the Anacortes refinery as well as the Port of Vancouver. We also try to drive a very efficient system. It's not a matter of having lots a lots of rail cars, it using the rail cars that you have because they add a cost to your system. We have a very efficient delivery system.

Matthew Blaire - *Macquarie Research Equities - Analyst*

Great, thanks.

Operator

Mohit Patwa, Citigroup.

Mohit Patwa - *Citigroup - Analyst*

Yes, I just had a question on Pacific Northwest utilization. 182,000 barrels per day in third quarter is as high as you guys have run in last five years and the guidance that you're giving for the fourth quarter is obviously lower than that. So, just wanted to see what your thought process is over there? What's the maximum you could do and what you would like to run those assets at?

Scott Spendlove - *Tesoro Corp - SVP, CFO*

Yes, let me take that one. Third quarter was a full utilization of both refineries in the Pacific Northwest, the fourth-quarter reduction acknowledges the demand drop-off in Alaska, so that's what you're seeing there. As far as the rate we saw the third quarter relative to prior quarters and years, earlier in the year when we completed the turnaround in Anacortes, we removed some constraints in the crude unit itself that allowed us to return the facility to its full throughput capabilities.



Mohit Patwa - Citigroup - Analyst

Thank you. One final one on RINs. Greg, this is the first time you actually mentioned it. You've always maintained that you've been pretty well protective as far as RINs are concerned. Just if you can give an idea of what your cost was during this year? As you said it's going to insignificant in the fourth quarter, but just to give us an idea of what it was in 2013?

Greg Goff - Tesoro Corp - President & CEO

If you look at our overall system, there's three or four things that you have to consider. One, which we've said in the past, is that as a Company from a gasoline standpoint, we're about 85% integrated, so we market about 85% of our gasoline to customers where we're blending. From a gasoline exposure standpoint, it's relatively limited. That's the first thing. The second thing is that we also, as we've talked about here two or three times, we export off of the West Coast both gasoline and diesel, which also lessens are need for RINs and that export amount for us has been relatively stable over the last years. We expect it to stay the same way, so that lessens it. Really the final thing is that we went into 2013 with a long position in RINs, which helped us out. From an overall cost standpoint, it wasn't an impact for Tesoro for 2013 because of the way we position our business.

Mohit Patwa - Citigroup - Analyst

Thank you for your comments.

Operator

Jeff Dietert, Simmons.

Jeff Dietert - Simmons & Company International - Analyst

Doug brought up the question earlier on Mid-Continent product pricing, whether or not it is tied to Brent or LLS. It appears recent product prices in the Mid-Continent have been more highly correlated with LLS then with Brent. Do you view that as a temporary situation or seasonal situation? How do you think about that?

Greg Goff - Tesoro Corp - President & CEO

Seasonal at the present time, Jeff. Particularly, as we look at the markets and that and what we see happening is with the data and that that's available to us, it's just the and seasonal so far. We'll have to stay, monitor and see what happens as we go forward. Our believe has always been that the product prices would trade off of Brent, or trade relative to Brent.

Jeff Dietert - Simmons & Company International - Analyst

Global prices?

Greg Goff - Tesoro Corp - President & CEO

Yes.

Jeff Dietert - Simmons & Company International - Analyst

Thanks your comment.

Operator

Ladies and gentlemen conclude your question-and-answer session. Thank you for participating. You may now disconnect your lines. Have a good day, thank you.

DISCLAIMER

Thomson Reuters reserves the right to make changes to documents, content, or other information on this web site without obligation to notify any person of such changes.

In the conference calls upon which Event Transcripts are based, companies may make projections or other forward-looking statements regarding a variety of items. Such forward-looking statements are based upon current expectations and involve risks and uncertainties. Actual results may differ materially from those stated in any forward-looking statement based on a number of important factors and risks, which are more specifically identified in the companies' most recent SEC filings. Although the companies may indicate and believe that the assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate or incorrect and, therefore, there can be no assurance that the results contemplated in the forward-looking statements will be realized.

THE INFORMATION CONTAINED IN EVENT TRANSCRIPTS IS A TEXTUAL REPRESENTATION OF THE APPLICABLE COMPANY'S CONFERENCE CALL AND WHILE EFFORTS ARE MADE TO PROVIDE AN ACCURATE TRANSCRIPTION, THERE MAY BE MATERIAL ERRORS, OMISSIONS, OR INACCURACIES IN THE REPORTING OF THE SUBSTANCE OF THE CONFERENCE CALLS. IN NO WAY DOES THOMSON REUTERS OR THE APPLICABLE COMPANY ASSUME ANY RESPONSIBILITY FOR ANY INVESTMENT OR OTHER DECISIONS MADE BASED UPON THE INFORMATION PROVIDED ON THIS WEB SITE OR IN ANY EVENT TRANSCRIPT. USERS ARE ADVISED TO REVIEW THE APPLICABLE COMPANY'S CONFERENCE CALL ITSELF AND THE APPLICABLE COMPANY'S SEC FILINGS BEFORE MAKING ANY INVESTMENT OR OTHER DECISIONS.

©2013, Thomson Reuters. All Rights Reserved.

