School of Business Investment Program

Tesoro Corporation [TSO]
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Investment Thesis

- Integrated business model & acquisitions
- Strong financials (FCF/share & low debt)
- Premium marketing brands
- Minimal commodity price exposure
- Positive energy outlook
Sector Overview - Energy

• OPEC’s decision to cut oil production in Jan.
• Reduce output by 1.2 million barrels/day
• WTI: $51.68
  Brent: $54.46
Sector Overview - Energy

OPEC Effect
Crude oil jumps after group agrees to production cuts

Source: Bloomberg
Company Overview

• Headquartered in San Antonio, TX
• Leading independent refiner and marketer of petroleum products

• Operates through 3 segments: • Employees: 6,000
  • Refining
  • TLLP
  • Retail & Marketing
Company Overview
History of Tesoro

- **1968**: Tesoro Corporation founded
- **1969**: Began operating first refinery in Kenai, Alaska
- **1998**: Acquired Anacortes, Wash. refinery
- **2001**: Acquired Salt Lake City, Utah refinery and Mandan, N.D. refinery
- **2002**: Acquired Golden Eagle Refinery in Martinez, Calif.
- **2007**: Acquired Los Angeles Refinery – Wilmington operations in Wilmington, Calif. as well as USA Gasoline brand and 138 retail sites
- **2007-2010**: Acquired 300 existing Shell branded wholesale supply contracts, expanding operations to a total of 650 Shell branded sites
- **2011**: Formed Tesoro Logistics LP, a master limited partnership that owns, operates, develops, and acquires logistics assets to gather crude oil and distribute, transport and store crude oil and refined products
- **2013**: Expanded Los Angeles Refinery with acquisition of Carson, Calif. operations. Acquired ARCO brand, *ampm* master franchisee license and approximately 800 dealer operated sites. Also, secured rights from ExxonMobil to use the Exxon and Mobil brands at retail stations in Northern California, Minnesota, Nevada, Central/Eastern North Dakota, Oregon, Northeastern South Dakota and Western Washington, and assumed ownership of branded wholesale supply contracts for 54 Exxon or Mobil branded retail stations in Minnesota
Refinery

- Operate seven refineries in the Western United States with a combined capacity of 895,000 barrels per day
- 59% domestic crude oil
- 41% foreign crude oil
- Products:
  - Gasoline
  - Diesel Fuels
  - Jet Fuel
  - Heavy Fuel Oils
  - Liquefied Petroleum Gas
  - Fuel Gases
  - Asphalt
  - Propane
  - Propylene

<table>
<thead>
<tr>
<th>REFINERY</th>
<th>LOCATION</th>
<th>CRUDE OIL CAPACITY</th>
<th>FAST FACT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Anacortes Refinery</td>
<td>Anacortes, Wash.</td>
<td>120,000 bpd</td>
<td>First facility on the West Coast to receive cost-advantaged Bakken shale oil by unit train</td>
</tr>
<tr>
<td>Dickinson Refinery</td>
<td>Dickinson, N.D.</td>
<td>20,000 bpd</td>
<td>First new refinery to be built in the U.S. in over 30 years</td>
</tr>
<tr>
<td>Kenai Refinery</td>
<td>Kenai, Alaska</td>
<td>72,000 bpd</td>
<td>Tesoro's first refinery</td>
</tr>
<tr>
<td>Los Angeles Refinery</td>
<td>Los Angeles, Calif.</td>
<td>380,000 bpd</td>
<td>As one of the largest refineries on the West Coast, supplies 50 percent of jet fuel used by Los Angeles International Airport</td>
</tr>
<tr>
<td>Mandan Refinery</td>
<td>Mandan, N.D.</td>
<td>74,000 bpd</td>
<td>Only full slate refinery operating in North Dakota</td>
</tr>
<tr>
<td>Martinez Refinery</td>
<td>Martinez, Calif.</td>
<td>166,000 bpd</td>
<td>Second-largest refinery in Northern California</td>
</tr>
<tr>
<td>Salt Lake City Refinery</td>
<td>Salt Lake City, Utah</td>
<td>63,000 bpd</td>
<td>Largest refinery in Utah</td>
</tr>
</tbody>
</table>
Tesoro Logistics LP

- TLLP: gathering, processing, terminaling & transportation
- Charge fees for gathering, processing, etc. crude oil, gas & processed water
- Modest seasonality - regulatory restrictions & weather conditions
  - Higher volumes in summer, lower in winter
- 34% interest in TLLP
- On path to reach $650M of net earnings and $1B of EBITDA by 2017
Retail & Marketing

- Tesoro’s retail-marketing system includes more than 2,400 retail stations in 16 states under the ARCO, Shell, ExxonMobil, USA Gasoline, Rebel, and Tesoro brands.
  - Premium & value brands
  - Regional

- Wholesale
  - Independent Marketers
  - Commercial End Users
  - High Volume Retailers

- Commercial
Headquartered in San Antonio, TX
Western United States
Management Team

Gregory J. Goff
Chairman, President and Chief Executive Officer

Steven Sterin
Executive Vice President, Chief Financial Officer and Corporate Development

Cynthia (CJ) Warner
Executive Vice President, Operations
Acquisitions

- Nov. 16, 2016: TSO to acquire Western Refining (WNR) in 2017
  - All stock transaction, $6.4 Billion
  - Opportunities for logistics growth in the Permian Basin
  - Investigation into “breach of fiduciary responsibility” on WNRs part

- Sep. 6, 2016: TSO to acquire Virent, Inc.
  - Renewable fuels and chemical company
  - Part of Tesoro’s renewable fuels strategy
  - To reduce Tesoro’s compliance costs with federal renewable fuel standard
Acquisitions

**Pacific Northwest**
- TSO Site Count = 198
- WNR Site Count = 0

**Mid-Continent**
- TSO Site Count = 681
- WNR Site Count = 285

**California/Southwest**
- TSO Site Count = 1,591
- WNR Site Count = 260

- **Implement Operations Excellence Management System to improve reliability and reduce costs**
- **Consolidate corporate services and G&A**
- **Optimize logistics operational efficiencies and growth**
- **Increase procurement efficiency**
- **Reduce supply and distribution costs across value chain**
- **Improve working capital efficiency**
- **Enhance retail integration**

**Commercial integration and higher refining utilization**
Plans for Growth

- **Vancouver Energy Project** - supplying crude oil to the West Coast
  - Will increase competitive crude oil supply
  - Significant infrastructure exists: low development costs
  - Potential assets for offer to TLLP
  - Logistical expansion
  - **IRR 40%+, $59 Million in net earnings**

- **West Coast Mixed Xylene Project**
  - Growing market in Asia
  - Transportation cost advantage, relative to the gulf coast
  - Logistics opportunity
  - **IRR 20%, $56 Million in net earnings**
Plans for Growth

● Acquire retail businesses
  ○ Enhance convenience store position
  ○ Add 350 new retail locations by 2018

● Store improvements

● Focus on branded retail and investing in brands

● Expected to drive $150-$200M of growth to operating income for 2016-2018
Social Responsibility

- Reduced air emissions by 15% from 2014-2015
- Replaced all storage tanks and fuel lines at retail sites in 2015
  - Significantly decreases likelihood of an oil spill
- Led the Tesoro Afterschool STEM program in 2015
  - Partnered with 9 other non profits
- Several grants to California aquariums and STEM research
Oil Correlation

Tesoro’s Correlation With WTI Stands at 28%
Performance YTD

**TSO 90.41**

- **Open**: 92.34
- **Close**: 90.41
- **Low**: 90.13
- **High**: 93.02
- **Vol**: 1.97M
- **% Chg**: -14.20%
Performance 6M

TSO 90.47

- Open: 92.34
- Close: 90.47
- Low: 90.13
- High: 93.02
- Vol: 1.97M
- % Chg: 14.88%
Competition

Valero Energy Corp. (VLO)
- Refining & ethanol
- Located in the U.S., Canada, & the U.K.
- Significant portion of crude supply comes from the middle east
- Large renewables business (ethanol plants)

Phillips 66 (PSX)
- Midstream, chemicals, refining & marketing
- Primarily Gulf Coast operations
- Formed in 2012 from ConocoPhillips repositioning

Marathon Petroleum Corp. (MPC)
- One of our open positions
- Refining & marketing, Speedway, & Midstream (MLP)
- Large gulf coast & midwest U.S presence
## Comparables

<table>
<thead>
<tr>
<th></th>
<th>TSO</th>
<th>VLO</th>
<th>PSX</th>
<th>MPC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market Cap (B)</td>
<td>10.75 B</td>
<td>30.57 B</td>
<td>45.32 B</td>
<td>26.21 B</td>
</tr>
<tr>
<td>Refining Capacity (BPD)</td>
<td>~900,000</td>
<td>~2,900,000</td>
<td>~2,200,000</td>
<td>~1,700,000</td>
</tr>
<tr>
<td>Dividend Yield (%)</td>
<td>2.41% ($0.55)</td>
<td>3.48% ($0.60)</td>
<td>2.88% ($0.63)</td>
<td>2.88% ($0.36)</td>
</tr>
<tr>
<td>P/E</td>
<td>15.48</td>
<td>14.58</td>
<td>22.95</td>
<td>23.44</td>
</tr>
<tr>
<td>P/CF</td>
<td>6.16</td>
<td>6.30</td>
<td>7.83</td>
<td>6.92</td>
</tr>
<tr>
<td>FCF/Share</td>
<td>2.61</td>
<td>0.62</td>
<td>-0.20</td>
<td>-0.95</td>
</tr>
<tr>
<td>Average Levered FCF Margin (%)</td>
<td>1.68%</td>
<td>1.2%</td>
<td>0.57%</td>
<td>2.17%</td>
</tr>
<tr>
<td>ROE</td>
<td>31.94%</td>
<td>19.37%</td>
<td>18.89%</td>
<td>23.75%</td>
</tr>
<tr>
<td>EPS (recurring)</td>
<td>10.78</td>
<td>7.32</td>
<td>7.30</td>
<td>5.12</td>
</tr>
</tbody>
</table>
Comparables

Refiners Leverage Position

Tesoro has the Highest ROE (TTM)
# Valuation - DCF Model

## Global Assumptions

<table>
<thead>
<tr>
<th>Assumption</th>
<th>Value</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shares Outstanding (millions)</td>
<td>116.9</td>
<td></td>
</tr>
<tr>
<td>Price Per Share</td>
<td>$92.00</td>
<td></td>
</tr>
<tr>
<td>52 Week Low</td>
<td>$67.80</td>
<td></td>
</tr>
<tr>
<td>Analyst Opinions - Low</td>
<td>$86.00</td>
<td></td>
</tr>
<tr>
<td>Credit Rating</td>
<td>BBB</td>
<td></td>
</tr>
<tr>
<td>Risk-free rate</td>
<td>2.22%</td>
<td></td>
</tr>
<tr>
<td>Beta</td>
<td>1.57</td>
<td>1.57 Beta</td>
</tr>
<tr>
<td>52 Week High</td>
<td>$112.49</td>
<td></td>
</tr>
<tr>
<td>Analyst Opinions - High</td>
<td>$120.00</td>
<td></td>
</tr>
<tr>
<td>Alt. Cost of Debt</td>
<td></td>
<td>Leave blank if rating is available</td>
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</tbody>
</table>

## Growth and WACC Assumptions

<table>
<thead>
<tr>
<th>Assumption</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>Decay Rate</th>
<th>Alternative Growth Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Growth</td>
<td>2.0%</td>
<td>1.8%</td>
<td>1.6%</td>
<td>1.5%</td>
<td>1.3%</td>
<td>10%</td>
<td>0%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.5%</td>
<td>7.5%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Effective Tax Rate</td>
<td>34.0%</td>
<td>34.0%</td>
<td>34.0%</td>
<td>34.0%</td>
<td>34.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation &amp; Amortization</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td>3.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Expenditures</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NWC as % of Revenue</td>
<td>1.7%</td>
<td>1.7%</td>
<td>1.7%</td>
<td>1.7%</td>
<td>1.7%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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## Valuation - DCF Model

### DCF Output

<table>
<thead>
<tr>
<th>Scenario:</th>
<th>Base</th>
<th>Downside</th>
<th>Upside</th>
</tr>
</thead>
<tbody>
<tr>
<td>Terminal Growth Rate:</td>
<td>2.00%</td>
<td>2.50%</td>
<td>2.50%</td>
</tr>
<tr>
<td>Terminal Shares Outstanding:</td>
<td>116.9</td>
<td>116.9</td>
<td>116.9</td>
</tr>
<tr>
<td>Weighted Average Cost of Capital:</td>
<td>10.98%</td>
<td>12.26%</td>
<td>9.71%</td>
</tr>
<tr>
<td>Present Value of Forecasted Cash Flows:</td>
<td>4,635</td>
<td>2,548</td>
<td>5,015</td>
</tr>
<tr>
<td>Present Value of Perpetual Cash Flows:</td>
<td>11,434</td>
<td>6,437</td>
<td>17,438</td>
</tr>
<tr>
<td>Present Value of Total Cash Flows:</td>
<td>15,468</td>
<td>8,985</td>
<td>22,453</td>
</tr>
<tr>
<td>Value of Debt:</td>
<td>4,667</td>
<td>4,667</td>
<td>4,667</td>
</tr>
<tr>
<td>Value of Cash:</td>
<td>1,387</td>
<td>1,387</td>
<td>1,387</td>
</tr>
<tr>
<td>Value of Equity:</td>
<td>12,188</td>
<td>5,705</td>
<td>19,173</td>
</tr>
<tr>
<td>Value of Equity Per Share:</td>
<td>$104.27</td>
<td>$48.81</td>
<td>$164.03</td>
</tr>
<tr>
<td>Range (in %):</td>
<td>10%</td>
<td>10%</td>
<td>10%</td>
</tr>
</tbody>
</table>

| Value Per Share Range:                   | $93.84     | $43.93     | $147.62   |
| Current Price of Stock:                  | $90.47     | $90.47     | $90.47    |
| P/V Ratio:                               | 0.79x      | 1.69x      | 0.50x     |
| Potential Upside:                        | 3.7%       | -51.4%     | 63.2%     |

|                                           | -          | -          | -          |
SWOT Analysis

**Strengths:**
- Integrated business model
- Competitive advantage in logistics
- Markets fuel under premium brands
- Low correlation with crude oil prices

**Weaknesses:**
- Extremely competitive industry

**Opportunities:**
- Acquisition of WNR
- Portfolio transformation underway
- Mixed Xylene in Asia
- Vancouver Energy project

**Threats:**
- Investigation into WNR deal - threaten the acquisition
- Volatility of Crude Oil prices
- Regulatory Regulations
Recommendation

Buy 125 shares at $90.74. Total of $11,342.50
Portfolio Fit

Roughly 12.6% in energy (MPC & TSO).
Questions

Thank you for your time and attention. We would now like to open up the presentation to any questions you may have.