

TESORO LOGISTICS LP (TLLP: \$33.38)
February 8, 2012
Estimate Changes
Rating: Buy
Price Target: \$33.00

Market Data					
12-18 Month Price Target					\$33.00
52-Week Range					\$34.76 - \$21.00
ADTV - 90Day (000s)					54.5
Market Cap (\$MM)					\$1,018.4
Shares Out (MM)					30.5
Public Market Float (MM)					13.0
Dividend					\$1.45
Dividend/Yield					4.34%
Earnings Per Unit (EPU) (\$)					
FY DEC	2011	2012		2013	
	Actual	Previous	Current	Previous	Current
Q1	—	\$0.42	\$0.38E	\$0.61	\$0.62E
Q2	\$0.25A	\$0.49	\$0.44E	\$0.62	\$0.63E
Q3	\$0.49A	\$0.57	\$0.55E	\$0.63	\$0.62E
Q4	\$0.37A	\$0.56	\$0.57E	\$0.62	\$0.61E
YEAR	\$1.11A	\$2.04	\$1.95E	\$2.48	\$2.47E
Distribution Per Unit (\$)					
FY DEC	2011	2012		2013	
	Actual	Previous	Current	Previous	Current
Q1	—	—	\$0.375E	—	\$0.430E
Q2	\$0.245A	—	\$0.388E	—	\$0.450E
Q3	\$0.350A	—	\$0.400E	—	\$0.470E
Q4	\$0.363A	—	\$0.413E	—	\$0.480E
YEAR	\$0.957A	—	\$1.575E	—	\$1.830E
Valuation Ratio					
		FY11	FY12	FY13	
Debt/EBITDA		3.3x	1.8x	1.4x	
EBITDA/Interest		8.7x	15.8x	20.9x	
EV/EBITDA		25.0x	13.8x	10.5x	
P/DCF		26.3x	15.7x	12.8x	
Financial Data					
		FY11	FY12	FY13	
EBITDA		\$41.9A	\$75.8E	\$100.1E	
Balance Sheet					
		FY11	FY12	FY13	
Total Assets		\$170.2A	\$270.8E	\$343.5E	
Long Term Debt		\$50.0A	\$140.0E	\$190.0E	
Total SOE and Liab.		\$170.2A	\$270.8E	\$343.5E	

Company Description

Tesoro Logistics is a master limited partnership that gathers, transports, and stores crude oil and distributes, transports, and stores refined products. Its assets consist of a crude oil gathering system in the Bakken Shale/Williston Basin area, eight refined products terminals, and a crude oil and refined products storage facility and five related short-haul pipelines.

Total Return Still Looks Strong
Summary

Tesoro Logistics LP (TLLP) reported 4Q11 EBITDA of \$14.1 million, which was below our estimate of \$14.5 million and distributable cash flow of \$12.6 million, which was in line with our estimate. We believe Tesoro will be able to grow its operations through dropdown acquisitions and potentially benefit from Tesoro Corporation's (TSO-NR) desire to expand its logistics asset base. We believe Tesoro's distribution growth should be solid over the next several years, including estimated 2013 growth at 16.2%. We have a Buy rating and a \$33 price target on TLLP units.

Key Points

- **Results.** Tesoro reported 4Q11 EBITDA of \$14.1 million, compared with our estimate of \$14.5 million. Distributable cash flow was \$12.6 million, which was on par with our estimate. Operating income of \$12.1 million was lower than our estimate of \$12.4 million. Revenue was above our forecast. However, the Terminalling segment's expenses were higher than our estimate. While net income was a bit lower than forecasted, lower maintenance capex helped our DCF forecast match the reported results.
- **Our take.** The higher expenses were in part caused by the use of greater third-party trucking volumes and costs associated with repair work on segments of the High Plains pipeline. Tesoro expects to increase its trucking capabilities during the first quarter, which should help with cost control. The partnership looks like it remains on target to increase its EBITDA to \$100 million for 2013, which could be conservative if it undertakes further expansions or acquires assets.
- **Conference call.** Management expects to fund the recently announced dropdown primarily through revolver borrowings and Tesoro plans on expanding the revolver to \$300 million. This will give the partnership more financing options for future opportunities. Tesoro is seeing significant growth in demand for truck gathering in its Crude Oil Gathering segment. The partnership continues to see opportunities to grow its distribution through dropdowns, organic growth, optimization, and potential acquisitions.
- **Estimates.** We are lowering our 2012 EBITDA estimate to \$75.8 million from \$79.6 million and keeping our 2013 EBITDA estimate at \$100.1 million. We are reducing our 2012 DCF estimate to \$66.3 million from \$69.4 million and maintaining our 2013 DCF estimate at \$83.7 million. Our higher estimates primarily reflect slightly higher costs in 2012.
- **Investment thesis.** Tesoro's units have performed very well over the last several months. The total return profile continues to look strong. Combining the current yield of 4.3% and projected 2013 distribution growth of 16.2% results in a total return of 20.5%. We would be buying the units on dips and pullbacks. Our forecast for distribution growth could prove conservative if the partnership were to undertake further dropdown acquisitions from its parent.

Crude Oil Gathering Segment

Segment income of \$5.8 million was higher than our estimate of \$5 million. Pipeline throughput of 60,064 barrels per day (bpd) was higher than our modeled number of 58,750 bpd, while trucking volume of 27,007 was above our forecast of 23,600 bpd. Operating and maintenance expense, depreciation expense, and general and administrative expenses were above our estimates.

Terminalling - Transportation & Storage Segment

Segment income of \$7.8 million was lower than our estimate of \$8.5 million. Terminalling throughput of 137,378 bpd was above our modeled number of 135,000 bpd, while short-haul pipeline throughput of 64,468 was below our forecast of 67,000 bpd. Operating and maintenance expense of \$3.2 million was higher than our estimate of \$2.6 million, depreciation expense was in line with our estimate, while general and administrative expenses were above.

Figure 1 - Tesoro 4Q11 Estimated vs Actual Results

	WSI Est	Actual
Net Income	\$11.8	\$11.5
Interest Expense, net	\$0.6	\$0.5
Taxes	\$0.0	\$0.0
Other	\$0.0	\$0.0
DD&A	\$2.0	\$2.0
Adjusted EBITDA	\$14.5	\$14.1
DCF	\$12.6	\$12.6
Throughput (bpd):		
Pipeline	58,750	60,064
Trucking volume	23,600	27,007
Terminalling	135,000	137,378
Short-haul pipeline	67,000	64,468

Source: Partnership reports and Wunderlich Securities, Inc. estimates

Distribution

Tesoro previously announced a distribution of \$0.3625/unit (\$1.45/unit annualized) for the fourth quarter of 2011. The distribution represents a 3.6% increase over the \$0.35/unit (\$1.40/unit annualized) for the third quarter of 2011.

We are maintaining our 2012 distribution estimate at \$1.575/unit and our 2013 distribution estimate at \$1.83/unit. Our estimates provide a 16.2% growth rate in 2013. This compares quite favorably to the 7.1% estimated average growth in 2013 for liquids-based partnerships under our coverage. Our distributable cash flow estimates are \$2.12/unit for 2012 and \$2.60/unit in 2013, which equates to coverage ratios of 1.3x and 1.4x, respectively.

Estimates

We are lowering our 2012 EBITDA estimate to \$75.8 million from \$79.6 million and keeping our 2013 EBITDA estimate at \$100.1 million. We are reducing our 2012 DCF estimate to \$66.3 million from \$69.4 million and maintaining our 2013 DCF estimate at \$83.7 million. Our higher estimates primarily reflect slightly higher costs in 2012.

Figure 2 - Tesoro 2012 Estimates

	WSI Previous Est	WSI New Est
Net Income	\$63.5	\$60.9
Interest Expense, net	\$5.9	\$4.8
Taxes	\$0.0	\$0.0
Other	\$0.0	\$0.0
DD&A	\$10.1	\$10.1
Adjusted EBITDA	\$79.6	\$75.8
DCF	\$69.4	\$66.3
Throughput (bpd):		
Pipeline	62,080	61,698
Trucking volume	23,809	24,009
Terminalling	159,447	161,332
Short-haul pipeline	67,794	66,136

Source: Wunderlich Securities, Inc. estimates

Figure 3 – Tesoro Logistics – Model

\$ in millions except per unit data	1Q11	2Q11	3Q11	4Q11	2011	1Q12E	2Q12E	3Q12E	4Q12E	2012E	1Q13E	2Q13E	3Q13E	4Q13E	2013E
Operating Income	-	7.5	15.7	12.1	35.4	12.5	15.1	18.7	19.4	65.6	21.1	21.7	21.8	21.9	86.5
Interest expense, net	-	(0.5)	(0.6)	(0.5)	(1.6)	(0.5)	(1.3)	(1.4)	(1.5)	(4.763)	(1.6)	(1.8)	(1.9)	(2.1)	(7.4)
Other income	-	0.8	0.0	0.0	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Pre-tax income	-	7.9	15.1	11.5	34.6	12.0	13.8	17.3	17.8	60.9	19.4	19.9	19.9	19.8	79.1
Income Tax	-	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net Income	-	7.9	15.1	11.5	34.6	12.0	13.8	17.3	17.8	60.9	19.4	19.9	19.9	19.8	79.1
Net Income to General Partner	-	0.2	0.3	0.2	0.7	0.2	0.3	0.4	0.5	1.4	0.6	0.8	1.0	1.1	3.5
Net Income to Limited Partners	-	7.7	14.8	11.3	33.9	11.7	13.5	16.9	17.3	59.5	18.8	19.1	18.9	18.7	75.5
Net Income/Unit (Limited)	-	\$0.25	\$0.49	\$0.37	\$1.11	0.38	\$0.44	\$0.55	\$0.57	\$1.95	0.62	\$0.63	\$0.62	\$0.61	\$2.47
Limited Partnership Units	-	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5	30.5
EBITDA (total)	-	10.0	17.7	14.1	41.9	14.5	17.6	21.4	22.3	75.8	24.4	25.1	25.3	25.3	100.1
EBITDA (Limited Partners)	-	9.9	17.4	13.9	41.2	14.3	17.3	21.0	21.8	74.4	23.7	24.3	24.2	24.2	96.5
Other	-	(0.0)	(0.3)	(0.4)	(0.7)	(0.4)	(0.8)	(0.9)	(1.0)	(3.1)	(1.6)	(1.7)	(1.8)	(2.0)	(7.1)
Maintenance CAPEX	-	(0.3)	(0.3)	(1.2)	(1.7)	(1.0)	(1.1)	(2.1)	(2.1)	(6.4)	(2.3)	(2.2)	(2.3)	(2.3)	(9.3)
Distributable Cash Flow	-	9.7	17.2	12.6	39.5	13.2	15.6	18.3	19.1	66.3	20.5	21.2	21.1	21.0	83.7
Distributable Cash Flow (GP)	-	(0.2)	(0.3)	(0.3)	(0.8)	(0.3)	(0.3)	(0.4)	(0.6)	(1.6)	(0.8)	(1.0)	(1.3)	(1.4)	(4.4)
Distributable Cash Flow (LP)	-	9.5	16.8	12.3	38.7	12.9	15.3	17.9	18.6	64.7	19.7	20.1	19.8	19.6	79.3
Distributable Cash Flow/Unit	-	\$0.31	\$0.55	\$0.40	\$1.27	0.42	\$0.50	\$0.59	\$0.61	\$2.12	0.65	\$0.66	\$0.65	\$0.64	\$2.60
Distribution		\$0.2448	\$0.3500	\$0.3625	\$0.9573	\$0.3750	\$0.3875	\$0.4000	\$0.4125	\$1.5750	\$0.4300	\$0.4500	\$0.4700	\$0.4800	\$1.8300
Coverage Ratio					1.3x					1.3x					1.4x
Distribution Growth															16.2%
Debt/EBITDA										1.8x					1.9x
EBITDA/Interest Expense										15.9x					13.4x

Source: Partnership reports and Wunderlich Securities, Inc. estimates

Disclosures:

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Valuation/Risks

- We have a Buy rating on TLLP and a \$33 price target. Our price target is derived through a two-stage distribution discount model, which assumes a required rate of return of 8% and a long-term growth rate of 2.0%. Our terminal value in 2016 is \$38.08.
- MLPs are tax-advantaged investments. Congress or the IRS could decide to remove these tax benefits. This is the biggest risk to all MLPs.

General disclosures:

Prices are as of the close of 02/07/12.

Ratings Distribution (in Percentages) & Investment Banking Disclosure Chart Information

Ratings Distribution & Investment Banking Disclosure				
Rating	Count	Ratings Distribution*	Count	Investment Banking**
Buy -rated	147	63.10	20	13.61
Hold -rated	80	34.30	8	10.00
Sell -rated	6	2.60	0	0.00

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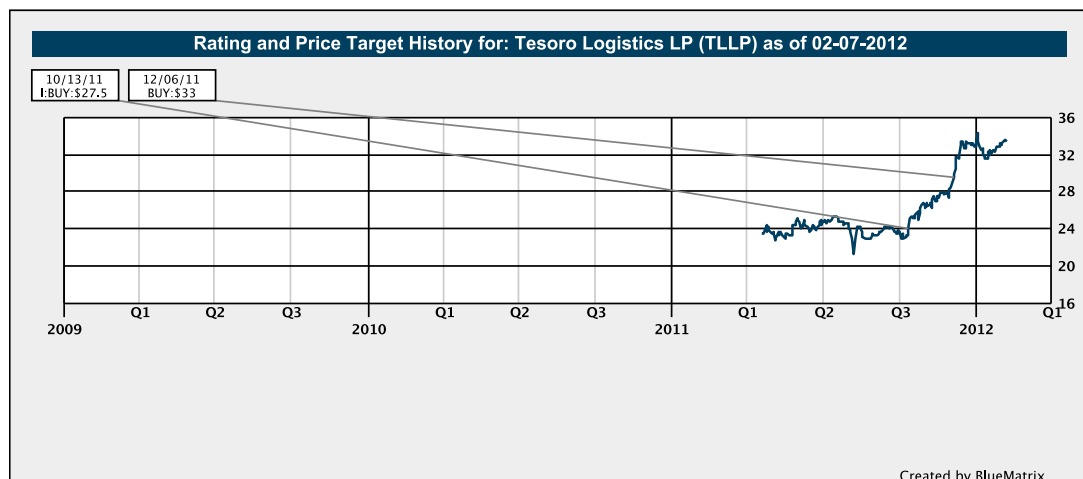
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