

TESORO LOGISTICS LP (TLLP: \$26.61)
November 8, 2011
Estimate Changes
Rating: Buy
Price Target: \$27.50

Market Data					
12-18 Month Price Target					\$27.50
52-Week Range					\$27.18 - \$21.00
ADTV - 90Day (000s)					69.4
Market Cap (\$MM)					\$849.8
Shares Out (MM)					30.5
Public Market Float (MM)					12.7
Dividend					\$1.40
Dividend/Yield					5.26%
Earnings Per Unit (EPU) (\$)					
FY DEC	2011	2012		2013	
	Estimate	Previous	Current	Previous	Current
Q1	—	\$0.37	\$0.42E	\$0.45	\$0.53E
Q2	\$0.25A	\$0.41	\$0.47E	\$0.45	\$0.54E
Q3	\$0.49A	\$0.45	\$0.57E	\$0.45	\$0.56E
Q4	\$0.38E	\$0.45	\$0.54E	\$0.45	\$0.53E
YEAR	\$1.12E	\$1.69	\$2.00E	\$1.80	\$2.16E
Distribution Per Unit (\$)					
FY DEC	2011	2012		2013	
	Estimate	Previous	Current	Previous	Current
Q1	—	—	\$0.370E	—	\$0.410E
Q2	\$0.245A	—	\$0.380E	—	\$0.420E
Q3	\$0.350A	—	\$0.390E	—	\$0.430E
Q4	\$0.360E	—	\$0.400E	—	\$0.440E
YEAR	\$0.955E	—	\$1.540E	—	\$1.700E
Valuation Ratio					
		FY11	FY12	FY13	
Debt/EBITDA		1.2x	0.7x	0.6x	
EBITDA/Interest		17.6x	30.3x	32.8x	
EV/EBITDA		19.2x	11.2x	10.3x	
P/DCF		21.0x	12.4x	11.6x	
Financial Data					
		FY11	FY12	FY13	
EBITDA		\$42.2E	\$72.8E	\$78.7E	
Balance Sheet					
		FY11	FY12	FY13	
Total Assets		\$163.2E	\$177.9E	\$193.7E	
Long Term Debt		\$50.0E	\$50.0E	\$50.0E	
Total SOE and Liab.		\$163.2E	\$177.9E	\$193.7E	

Earnings Above Estimates; Growth Should Continue
Summary

Tesoro Logistics LP (TLLP) reported 3Q11 EBITDA of \$17.7 million and distributable cash flow of \$17.2 million, which were above our estimates. 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 distribution growth at 10.4%. We have a Buy rating and a \$27.50 price target.

Key Points

- **Results.** Tesoro reported 3Q11 EBITDA of \$17.7 million, compared with our estimate of \$14.4 million. Distributable cash flow was \$17.2 million, which was higher than our estimate of \$12.5 million. Operating income of \$15.7 million was higher than our estimate of \$12 million. The main contributors to the difference between actual and estimated DCF was the higher operating income, lower maintenance capex, and lower cash interest paid.
- **Our take.** This was the partnership's first full quarter of operations after its IPO and operationally Tesoro continues to perform well. Although both of its segments were above our expectations, Tesoro's Terminalling segment far exceeded our estimates. Throughput was above our forecast, while expenses were much lower. The quarterly results benefited from a \$2 million credit that will be reduced to \$1 million going forward and was not part of Tesoro's original guidance.
- **Conference call.** Management believes that there is significant opportunity to grow operationally, which should result in higher cash flow. The partnership continues to work with Tesoro Corporation on a potential dropdown. Tesoro will give an update at an analyst meeting in early December. Management stated that it is seeing some cost pressure in the Bakken, but that is expected in a quickly developing area.
- **Estimates.** We are raising our 2011 EBITDA estimate to \$42.2 million from \$38.9 million and our 2012 EBITDA estimate to \$72.8 million from \$65.2 million. We are increasing our 2011 DCF estimate to \$39.5 million from \$34.8 million and our 2012 DCF estimate to \$67.1 million from \$58.4 million. Our higher estimates primarily reflect lower expenses, higher revenues, and lower cash interest expense.
- **Investment thesis.** We believe Tesoro is a good investment for several reasons, including: estimated 2013 distribution growth at 10.4%; it has several avenues for growth, including dropdown acquisitions; agreements with its parent that provide for minimum volume commitments; and it should remain in the low distribution split levels over the near term.

Crude Oil Gathering Segment

Segment income of \$6.6 million was higher than our estimate of \$6.2 million. Pipeline throughput of 59,530 barrels per day (bpd) was higher than our modeled number of 58,570 bpd, while trucking volume of 23,879 was above our forecast of 23,500 bpd. Operating and maintenance expense and depreciation expense were below our estimates, while general and administrative expenses were above.

Terminalling - Transportation & Storage Segment

Segment income of \$10.2 million was higher than our estimate of \$6.8 million. Terminalling throughput of 144,997 bpd was well above our modeled number of 120,000 bpd, while short-haul pipeline throughput of 69,658 was above our forecast of 65,500 bpd. Operating and maintenance expense of \$1.4 million was significantly lower than our estimate of \$3.6 million and depreciation expense was below our estimate, while general and administrative expenses were above.

The results benefited from a \$2 million credit, which will be reduced to \$1 million going forward. Volumes should be lower in the fourth quarter due to seasonality.

Figure 1 - Tesoro 3Q11 Estimated vs Actual Results

	WSI Est	Actual
Net Income	\$11.4	\$15.1
Interest Expense, net	\$0.7	\$0.6
Taxes	\$0.0	\$0.0
Other	\$0.0	\$0.0
DD&A	\$2.3	\$2.0
Adjusted EBITDA	\$14.4	\$17.7
DCF	\$12.5	\$17.2
Throughput (bpd):		
Pipeline	58,750	59,530
Trucking volume	23,500	23,879
Terminalling	120,000	144,997
Short-haul pipeline	65,500	69,658

Source: Partnership reports and Wunderlich Securities, Inc. estimates

Distribution

Tesoro previously announced a distribution of \$0.35/unit (\$1.40/unit annualized) for the third quarter of 2011. The distribution represents a 4% increase over the pro rated \$0.2448/unit for the second quarter 2011 distribution. The distribution was in line with our estimate.

We are maintaining our distribution estimates at \$0.9548/unit for 2011, \$1.54/unit for 2012, and \$1.70/unit for 2013. Our estimates provide a 10.4% growth rate in 2013. This compares quite favorably to the 5.7% estimated average growth in 2013 for liquids-based partnerships under our coverage. Based on our distributable cash flow estimate of \$2.15/unit for 2012 and \$2.30/unit in 2013, coverage ratios would be 1.4x for both years.

Estimates

We are raising our 2011 EBITDA estimate to \$42.2 million from \$38.9 million and our 2012 EBITDA estimate to \$72.8 million from \$65.2 million. We are increasing our 2011 DCF estimate to \$39.5 million from \$34.8 million and our 2012 DCF estimate to \$67.1 million from \$58.4 million. Our higher estimates primarily reflect lower expenses, higher revenues, and lower cash interest expense.

Figure 2 - Tesoro 2011 Estimates

	WSI Previous Est	WSI New Est
Net Income	\$30.7	\$34.9
Interest Expense, net	\$1.8	\$1.7
Taxes	\$0.0	\$0.0
Other	\$0.0	\$0.0
DD&A	\$6.4	\$5.7
Adjusted EBITDA	\$38.9	\$42.2
DCF	\$34.8	\$39.5
Throughput (bpd):		
Pipeline	57,085	57,325
Trucking volume	23,098	23,193
Terminalling	123,340	133,339
Short-haul pipeline	65,212	66,251

Source: Wunderlich Securities, Inc. estimates

Figure 3 – Tesoro Logistics – Model

\$ in millions except per unit data	1Q11	2Q11	3Q11	4Q11E	2011E	1Q12E	2Q12E	3Q12E	4Q12E	2012E	1Q13E	2Q13E	3Q13E	4Q13E	2013E
Operating Income	-	7.5	15.7	12.4	35.7	13.7	15.2	18.3	17.5	64.6	17.1	17.5	18.3	17.5	70.4
Interest expense, net	-	(0.5)	(0.6)	(0.6)	(1.7)	(0.6)	(0.6)	(0.6)	(0.6)	(2.404)	(0.6)	(0.6)	(0.6)	(0.6)	(2.4)
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	11.8	34.9	13.1	14.6	17.7	16.9	62.2	16.5	16.9	17.7	16.9	68.0
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	11.8	34.9	13.1	14.6	17.7	16.9	62.2	16.5	16.9	17.7	16.9	68.0
Net Income to General Partner	-	0.2	0.3	0.2	0.7	0.3	0.3	0.4	0.4	1.3	0.4	0.5	0.6	0.7	2.2
Net Income to Limited Partners	-	7.7	14.8	11.6	34.2	12.8	14.3	17.3	16.5	60.9	16.1	16.4	17.1	16.3	65.9
Net Income/Unit (Limited)	-	\$0.25	\$0.49	\$0.38	\$1.12	0.42	\$0.47	\$0.57	\$0.54	\$2.00	0.53	\$0.54	\$0.56	\$0.53	\$2.16
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	14.5	42.2	15.7	17.2	20.3	19.5	72.8	19.2	19.5	20.4	19.6	78.7
EBITDA/Unit	-	\$0.33	\$0.58	\$0.47	\$1.38	0.51	\$0.57	\$0.67	\$0.64	\$2.39	0.63	\$0.64	\$0.67	\$0.64	\$2.58
EBITDA (Limited Partners)	-	9.9	17.4	14.2	41.5	15.4	17.0	20.0	19.1	71.5	18.7	19.0	19.8	18.9	76.5
EBITDA/Unit	-	\$0.32	\$0.57	\$0.47	\$1.36	0.51	\$0.56	\$0.65	\$0.63	\$2.34	0.61	\$0.62	\$0.65	\$0.62	\$2.51
Other	-	(0.0)	(0.3)	(0.4)	(0.7)	(0.4)	(0.4)	(0.4)	(0.4)	(1.4)	(0.5)	(0.5)	(0.5)	(0.5)	(1.8)
Maintenance CAPEX	-	(0.3)	(0.3)	(1.5)	(2.1)	(1.2)	(1.0)	(1.0)	(1.0)	(4.2)	(1.0)	(1.0)	(1.0)	(1.0)	(4.0)
Distributable Cash Flow	-	9.7	17.2	12.6	39.5	14.1	15.9	19.0	18.2	67.1	17.7	18.1	18.9	18.1	72.8
Distributable Cash Flow (GP)	-	(0.2)	(0.3)	(0.3)	(0.8)	(0.3)	(0.3)	(0.4)	(0.4)	(1.4)	(0.5)	(0.6)	(0.7)	(0.8)	(2.5)
Distributable Cash Flow (LP)	-	9.5	16.8	12.3	38.7	13.8	15.6	18.6	17.7	65.7	17.2	17.5	18.2	17.4	70.3
Distributable Cash Flow/Unit	-	\$0.31	\$0.55	\$0.40	\$1.27	0.45	\$0.51	\$0.61	\$0.58	\$2.15	0.56	\$0.57	\$0.60	\$0.57	\$2.30
Distribution		\$0.2448	\$0.3500	\$0.3600	\$0.9548	\$0.3700	\$0.3800	\$0.3900	\$0.4000	\$1.5400	\$0.4100	\$0.4200	\$0.4300	\$0.4400	\$1.7000
Coverage Ratio					1.3x					1.4x					1.4x
Distribution Growth															10.4%
Debt/EBITDA										0.7x					0.6x
EBITDA/Interest Expense										30.3x					32.7x

Source: Partnership reports and Wunderlich Securities, Inc. estimates

Disclosures:

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Valuation/Risks

- We have a Buy rating on TLLP and a \$27.50 price target. Our price target is derived through a two-stage distribution discount model, which assumes a required rate of return of 8.5% and a long-term growth rate of 2.0%. Our terminal value in 2016 is \$30.91.
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General disclosures:

Prices are as of the close of 11/07/11.

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

Ratings Distribution & Investment Banking Disclosure				
Rating	Count	Ratings Distribution*	Count	Investment Banking**
Buy -rated	142	64.00	18	12.68
Hold -rated	77	34.70	5	6.49
Sell -rated	3	1.40	0	0.00

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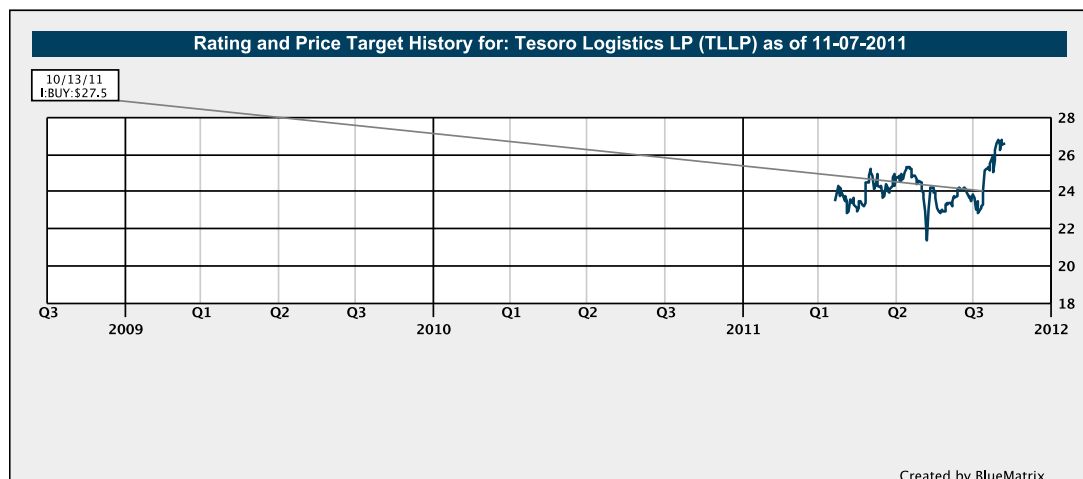
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