

<b>Tesero</b> <b>Ticker:</b> TSO <b>Sector:</b> Energy <b>Industry:</b> Refining & Marketing	<b>Intrinsic Value:</b> \$137.83 <b>Current Price:</b> \$48.78 <b>Stop/Loss:</b> \$41.63 <b>Upside Review:</b> \$58.54	<b>TTM P/E:</b> 16.37 <b>Forward P/E:</b> 16.69 <b>FV Imp. P/E:</b> 12.87 <b>Beta:</b> 1.15	<b>Market Cap:</b> \$6.48 B <b>Dividend Yield:</b> 2.05% <b>52 Wk Range:</b> 40.90 – 65.75
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**Industry Trends:** With dependable and less-costly domestic production of both crude and shale gas increasing, U.S. refiners possess a margin advantage relative to foreign peers. Although domestic product demand growth has been relatively stagnant, exports offer a growth vehicle thanks to overseas demand. Also, the deluge of light, sweet crude oil will likely overwhelm existing capacity and pressure prices without additional capital allocated to process these oil blends.

**Investment Thesis:** West Coast-dominated footprint means it is one of the last refiners to realize the full benefit of domestic discount crude. Its first step to capitalize on discount light crude was the 50 mb/d rail project to bring Bakken crude to its Washington refinery, resulting in cheaper feedstock and higher margins of \$3-\$5/bbl thanks to yield improvement. Increasing throughput of discount crude from the midcontinent and Canada via rail will have a greater role in improving Tesoro's overall profitability. To do so, Tesoro recently entered an agreement to develop a crude by rail and marine facility in Washington. The increased throughput of discount crude along with the integration of Carson Refinery into its system could ultimately deliver upwards of \$490 million in annual EBITDA improvement.

**Business Summary:** Tesoro Corporation is an independent petroleum refiner and marketer in the United States with two operating segments: refining crude oil and selling refined products in bulk and wholesale markets and selling motor fuels in the retail market.

**FEB: 5 year stock performance:**



Direct Competitor Comparison					
	TSO	HFC	PVT1	VLO	Industry
Market Cap:	6.80B	8.88B	N/A	25.92B	N/A
Employees:	N/A	2,534	N/A	10,500	9,28K
Ctrly Rev Growth (yoy):	0.24	0.02	N/A	-0.00	0.00
Revenue (ttm):	37.60B	20.48B	N/A	138.07B	N/A
Gross Margin (ttm):	0.04	0.11	N/A	0.05	0.08
EBITDA (ttm):	1.25B	2.12B	N/A	5.67B	N/A
Operating Margin (ttm):	0.02	0.09	N/A	0.03	0.04
Net Income (ttm):	392.00M	1.07B	N/A	2.72B	N/A
EPS (ttm):	3.00	5.28	N/A	4.97	1.05
P/E (ttm):	16.22	8.46	N/A	9.67	N/A
PEG (5 yr expected):	0.80	-2.58	N/A	1.22	N/A
P/S (ttm):	0.18	0.42	N/A	0.19	N/A

**Competitive Analysis:**

Tesoro's refineries are chiefly based in California, which has resulted in the company not fully realizing midcontinent discounts. The company does have the only refinery in the Bakken region. Past and future infrastructure improvements should help capture these discounts. Main competitors include Valero, HollyFrontier, and Shell Oil Products.

**Pros:**

- Increase the flow of discount crude to the West Coast by 325 mb/d resulting in lower cost feedstock and improved yields
- The Carson acquisition essentially paid for itself thanks to the associated logistics assets. Not only did Tesoro add cheap capacity, but integration with the Wilmington refinery should lower costs
- Expansion of marketing channels should allow Tesoro to increase sales volumes and run its refineries at higher levels of capacity

**Risk Factors:**

- Legislation designed to curb carbon emissions may target refiners and result in higher costs and significant capital requirements.
- Realized discounts will be less than Mid-Continent and Gulf Coast peers while also being most at risk
- The acquisition of Carson increases leverage to California where demand remains weak and excess refinery capacity results in periods of oversupply and lower margins.

**Total Return Estimates:**

<b>3 Yr FV Reversion*:</b>	82.42% p.a.
<b>5 Yr FV Reversion*:</b>	44.59% p.a.

(\* - From limit order price of \$48.78)

**Key Valuation Assumptions:**

Est. Revenue Growth	9.62%
WACC	9.69%
Expected Inflation	3.5%
Terminal Growth Rate	3%
10 yr. Risk Free Rate	2.72%
Equity Risk Premium	5.9%
Tax Rate	36.18%

**Key Financial Data:**

Est. 2013 EPS	3.05
Est. 2014 EPS	6.71
3-5 Yr. Est. EPS Growth	5.17
PEG (TTM)	1.48
Credit Quality	BBB
ROE	18.76%
ROA	7.22%
Price /Book	1.47
Price/Cash Flow	6.13
Debt/Equity	63.8%
Current Ratio	1.65
Quick Ratio	.87

**CSR Scores**

Human Rights	1/1
Business Ethics Policy	1/1
ESG Disclosure Score	28.51/15.07
Equal Opportunity Score	1/1
Emission Reduction	1/1
Environmental Disclosure Score	11.63/14.21

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