

Tesoro Petroleum Corp. (NYSE: TSO) Buy**Volatility Risk: High**

Analyst: Clay Mahaffey

claym@investologyinc.net**12 month Price Target: \$40**

Date: October 19, 2004

Market Data		Fundamental Data*			
		FY03A	FY04E	FY05E	
Current share price (Oct 19, 04)	\$28.28	Capacity Utilization	87.5%	89.3%	87.1%
52 week Low-High (\$)	9.07-34.65	Gross Profit (\$ Million)	1,196	1,681	1,684
Diluted Shares Out. (Million)	68.6	Refining Margin/BOE	\$3.85	\$6.69	\$6.72
Market Cap. (Billion)	\$2.13	EPS (Diluted)	\$1.17	\$6.32	\$5.86
Insider Holding	3.50%	Price / Earnings (X)	24.17x	4.47x	4.82x
Fiscal Year End	31-Dec	Price / NAV (X)		1.5x	
Book value/share (Jun 30, 04)	\$18.85	EPS 3QFY04E		\$1.66	
Total Assets (Jun 30, 04) Billion	\$3.66	EPS 4QFY04E		\$0.79	

* Projections & estimates by the Analyst

We are initiating coverage of Tesoro (NYSE: TSO) with a BUY recommendation. TSO is an independent petroleum refiner and marketer with strong position in the West and California markets. We believe TSO is significantly undervalued for the following reasons: (i) '05 EPS will surprise on upside due to crack spreads (difference between gasoline and fuel oil costs and cost of crude: an approximation of gross margin) NOT declining to the extent of the Consensus estimate. (ii) Partial reduction of the excessive discount to peer group (currently over 30%) (iii) Very high free cash flow due to margins and few capex requirements (iv) Potential for being an acquisition candidate due to valuation and strategic refinery locations. These company specific factors are in addition to the industry fundamentals that should remain tight at least through 2006.

Catalysts

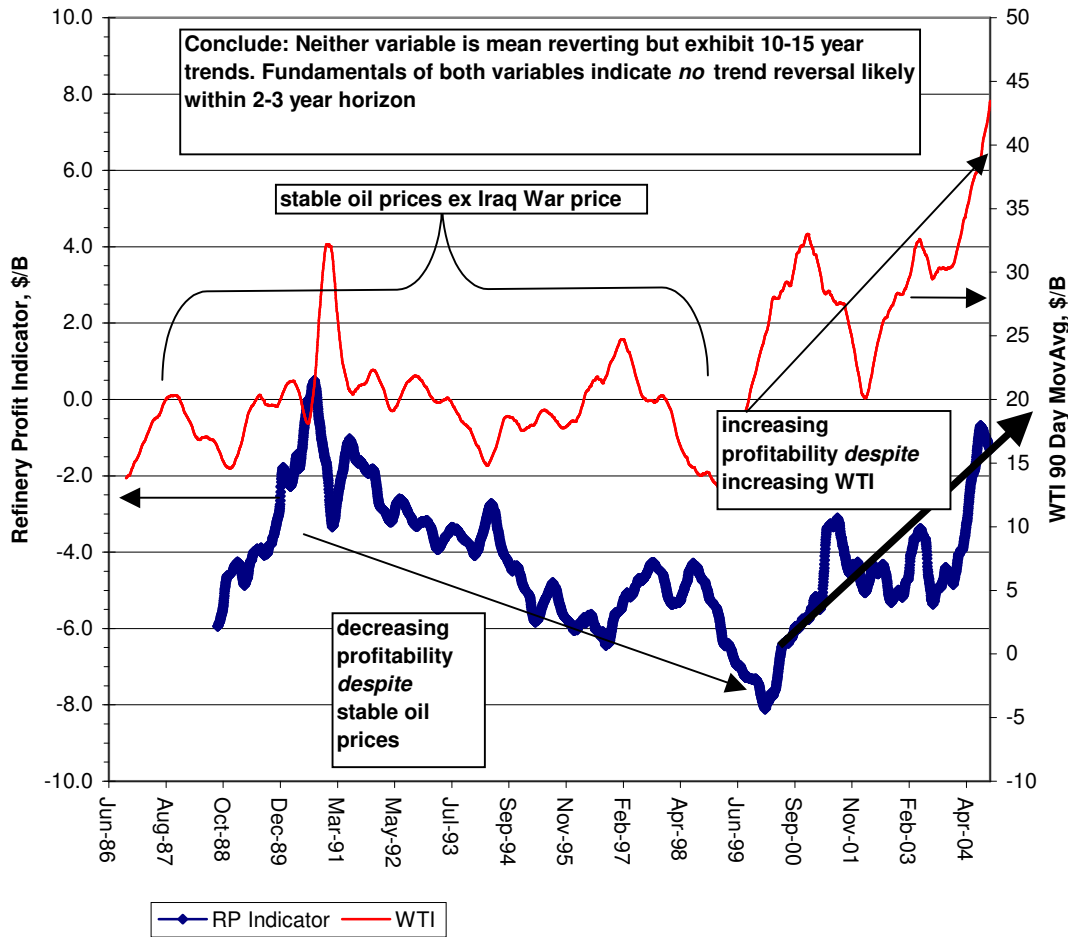
- *Q3 financials surprising on upside (est \$1.66 vs Consensus \$1.23 and Q3'03 \$1.09)*
- *Providing guidance on '04 and '05 earnings and free cash flow,*
- *Management decisions at the November Board meeting to distribute excess cash to shareholders via dividend or stock buy back, and adopting poison pill measures to block unsolicited acquisitions. This would provide visibility on key issues: earnings and free cash flow estimates for '05 and strategic plans. Management has been silent to date, perhaps contributing to the unusually wide disparity in estimates of these key factors and resulting large market discount.*

(PLEASE SEE IMPORTANT DISCLOSURES AT THE END OF THIS REPORT & DISCUSSION OF KEY RISK FACTORS ON PAGE 11.)

Investment Rationale**1. Fundamental Strength of US Refining Segment**

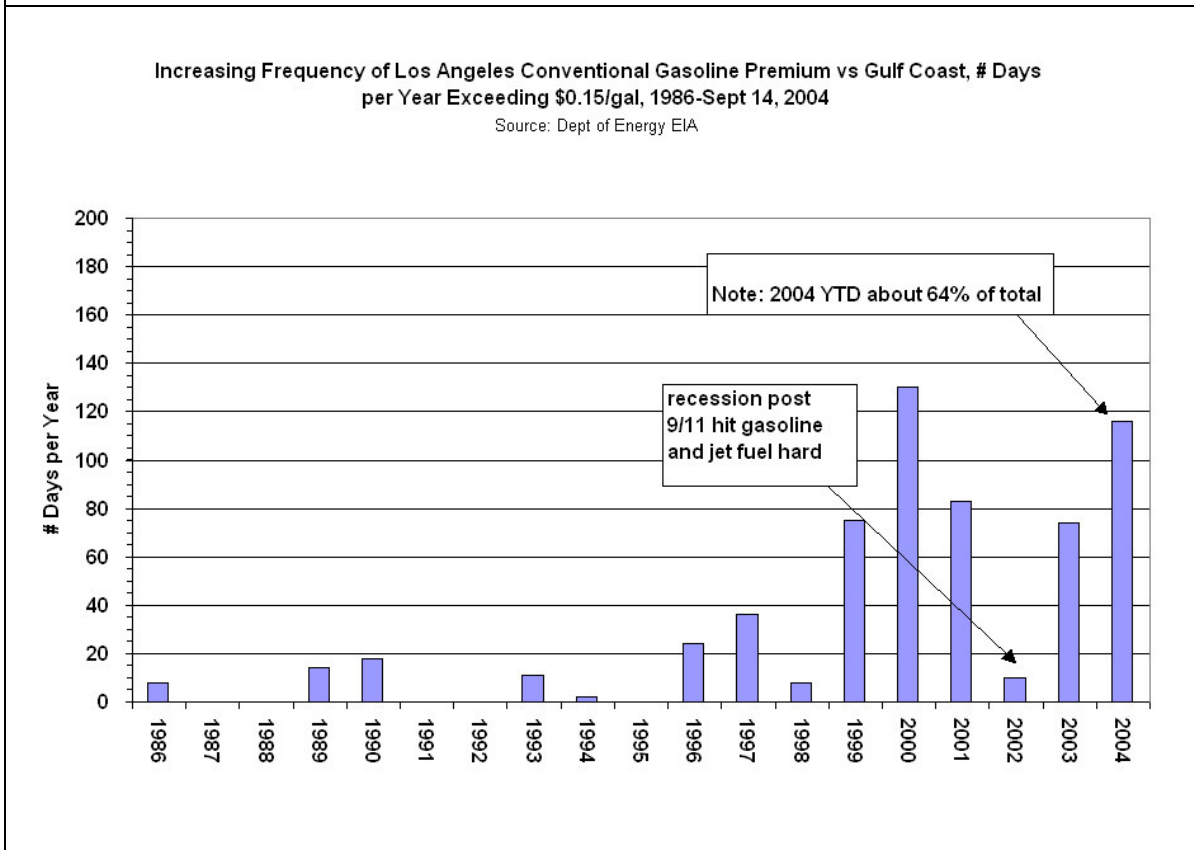
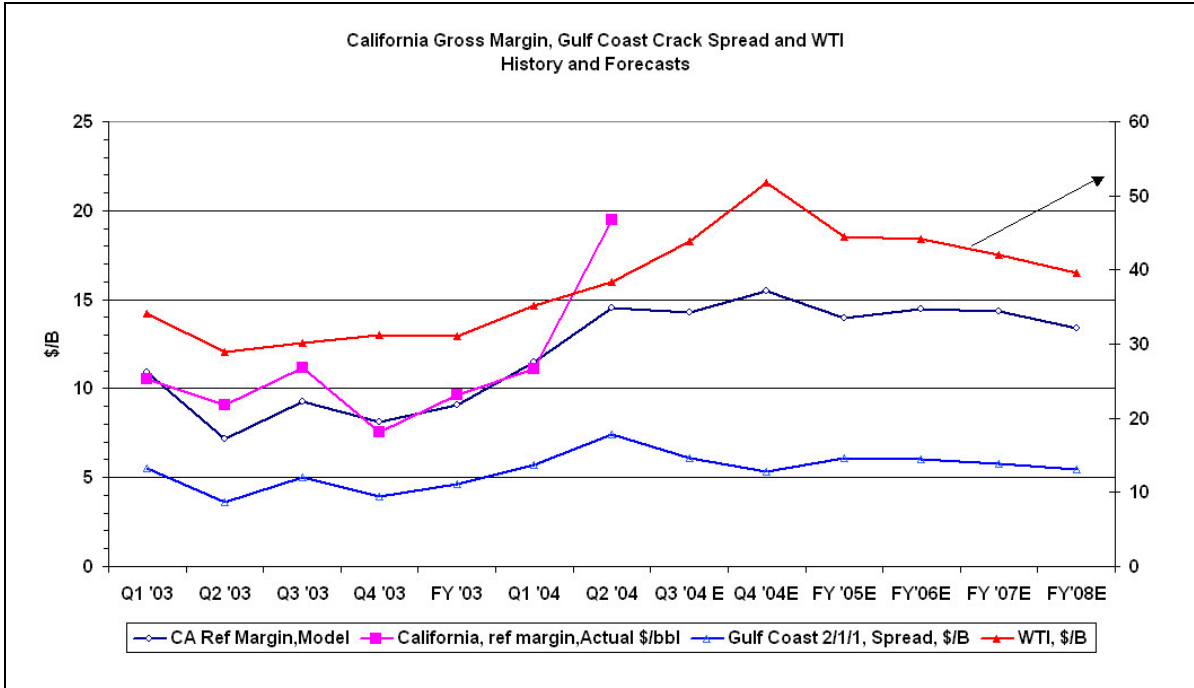
- We believe a long-term secular trend, not cyclical boom and bust, is in place. This is based on the lack of correcting mechanisms (increased supply and/or reduced demand) being in place over the next several years. US refineries are at 95% of capacity and our dependence on imported refined products has doubled in the last several years to over 10% today. The reason for this is a decade long period of under investment and now there is no way to catch up, so this dependence on imported products is likely to grow. US capacity growth ('creep') has been steady but inadequate to meet demand growth
- The US will be increasingly dependent on imported refined products given our relatively high costs and environmental obstacles for new construction vs offshore facilities. Some excess off shore refining capacity exists but US specifications are more difficult and expensive to meet, the markets are highly seasonal (summer- gasoline, winter- fuel oil), marine transportation costs have surged.
- As a consequence refining margins have increased faster than crude costs, and are likely to *decrease less* than potential future crude declines. This conclusion is based on our analysis of historic prices and margins over the last 24 years and identification of key turning points based on underlying fundamentals.

Figure 1
Refinery Profitability Indicator and WTI Crude History, 1986-2004



2. Strong Position in Lucrative California Gasoline Market

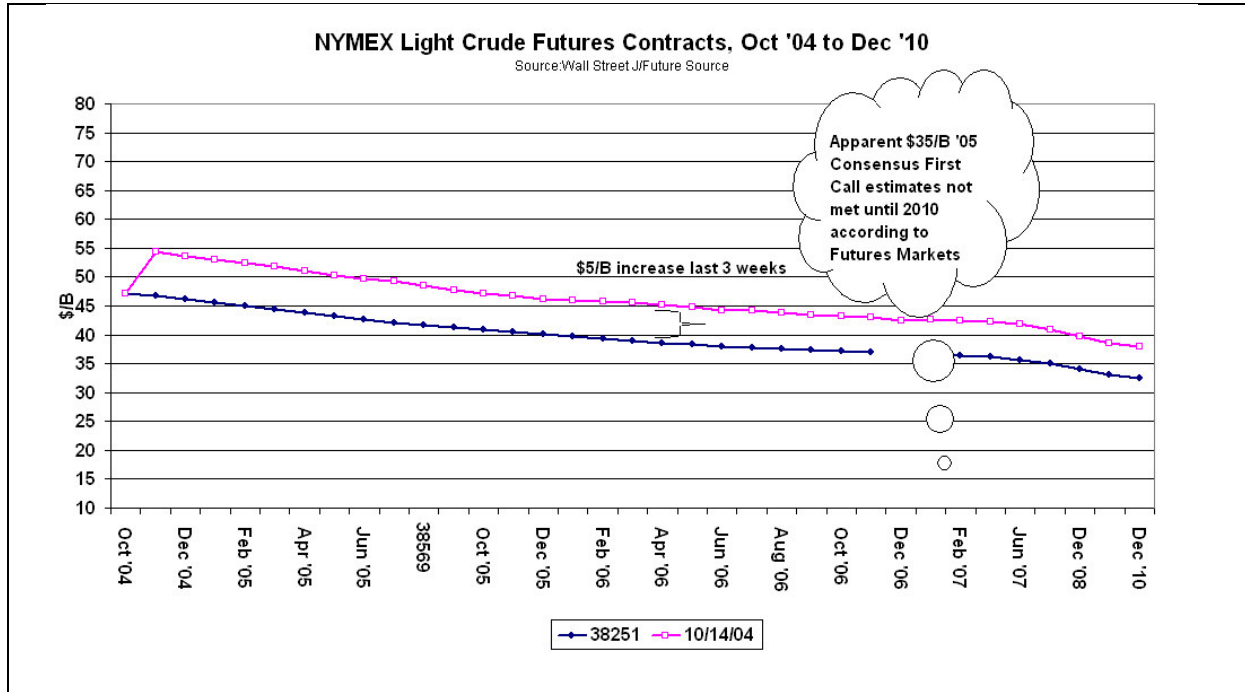
- California is a net importer of refined products as well as the highest volume growth market, and consistently has the highest refining margins in the US. TSO has more operating leverage to this market than any other refiner (>40% of gross margin from CA).
- No correcting mechanisms are in place due to strict environmental regulations and general NIMBY attitudes towards production, supply chain and refining investments.
- We analyzed over twenty years of pricing data and determined margins have increased nearly 50% since 2000. Prices have hit records in Q2, and may fall somewhat but are unlikely to collapse to '03 levels.



3. False Assumptions

- The 48% decline in First Call Consensus '04/'05 EPS estimates (\$5.45 to \$2.88) imply expectations that over the next 12 months crude prices and margins will decline substantially to 2003 levels. The underlying premise, that 2004 was a cyclical upturn

followed by a quick correction – is wrong, in our opinion. We believe fundamental long-term trends are in place and the correcting mechanisms- increased supply and/or reduced demand- are not likely in the next 2-3 years. The Methodology Section (call 203-355-0500 for a copy of the completer report) describes these trends and data from the last 20 years. The NYMEX Futures market confirms this bullish view as evidenced by the fact that implied refining margins from crude, gasoline and heating oil prices show a 15% increase, not decrease, in '05 vs '04. The collective opinion of all crude traders and participants that crude will not return to 2003 levels until 2010 is in stark contrast to Consensus First Call estimates of TSO EPS. *This is an exploitable anomaly that must be resolved.*



Although refining is certainly a commodity business, we believe the peak of the cycle will not be seen until additional supply sources develop. This is most likely to come as overseas investments are made that are dedicated to produce refined products for the US market, and due to the long lead time this is unlikely to happen in the next few years. The world refining capacity is being stretched to meet current local demand, much less export to the US. Any cyclical downturn in demand, even globally, would not reverse the secular demand growth from Developing Countries. An argument of possible recessionary demand reductions can be countered by considering unforeseen supply interruptions due to terrorism, over stated reserves and refining operational disruptions (US or worldwide).

Our '04 and '05 EPS estimates are \$6.32 and \$5.86 indicating PER of 4.7 and 5.0 times.

4. **Deleveraged Balance Sheet**

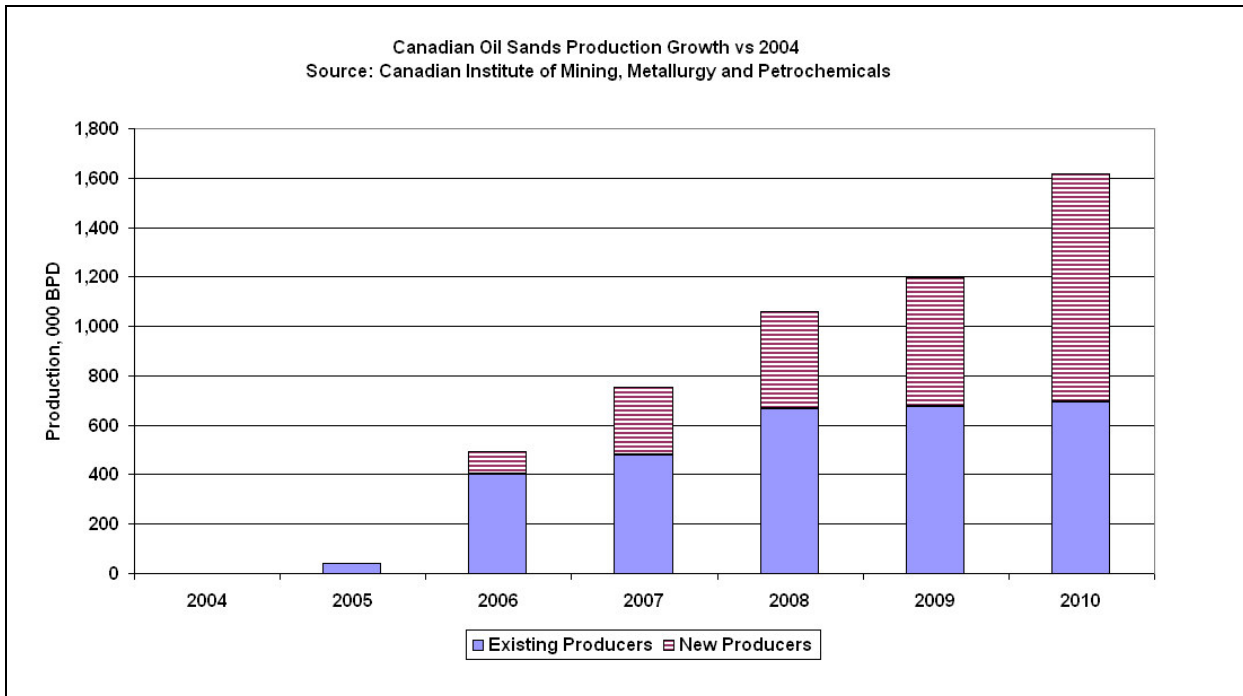
- Paid down \$1 billion of debt in last 2 + years including \$297 million 7/1/04 and \$100 million 9/30/04.
- Net total debt/total capitalization reduced from 67% 3/31/04 to forecast 32% 12/31/04

5. Excess Free Cash Flow – Return to Shareholders?

- Our projections are for about \$1.5+ billion in free cash flow generation over the next four years, exceeding the current debt of \$1.2 bil. Management indicates discussions of alternate use of free cash flow (share buyback and/or dividend) will be considered at the next Board meeting in November. Acquisitions or major capital expansions are not being considered, according to Management.

6. TSO remains an acquisition candidate.

- In our opinion, TSO’s current price undervalues the assets and thus is potentially attractive to a strategic buyer. Canadian oil sands producers (Suncor –SU, Syncrude Canada, Shell Canada) are poised to raise oil production >500,000 BPD by 2006 and need downstream refining capacity to move this product. Simply selling this volume of crude on the open market is likely to depress prices that can be avoided by integrating downstream to control sales of the new production.
- Oil sands producers more likely to make necessary investments than independent refiners due to stronger balance sheet and lower cost of capital (Suncor) or existence of major oil company partners (Syncrude Canada owned by Shell, Exxon and 5 others). By owning the refiner they can better control and manage disposition of their product for maximum advantage and displace competitive crude supply. Each of these companies has invested over \$5 billion in recent years to increase production and downstream capacity investment seems inevitable.
- TSO is well positioned due to owning refineries (WA, ND, UT) located on pipelines from Canada plus the lucrative California market position.



Valuation

Due to the high operating leverage (2.6 BPD throughput per share) a \$1 change in the crack spread changes EPS \$1.52. The critical issue in valuation of TSO is the relative '05 EPS estimate vs '04: according to First Call, TSO'05 EPS estimate is 49% lower than '04 whereas the peer group is about 10% lower. One explanation might be the expectation that the recently very high California margins will collapse. We describe at length our view this will not happen (see Methodology, Figures 1,2,3,7). *The excess California margins based on price spikes present a call option, which is not factored into the stock price.*

TSO has an Enterprise Value/EBITDA multiple of 3.6; 33% below the peer group of 5.4 times (excluding TSO). This discount seems undeserved, and our estimates indicate that it is likely to be cut in half by the catalysts identified. Our estimates are:

'05 EBITDA, \$ mil	942	
Multiple	4.6	33% discount reduced to 15%
Enterprise Value	4,333	
Less debt	-1,215	
Less cash	<u>-788</u>	(FY'05E)
Market Capitalization	2,330	
Shares outstanding, mil	70	
\$/share	\$33	

The Company was stressed in 2002 with the acquisition of the Golden Eagle Refinery in CA and increased debt, which resulted in losses due to low margins in a recessionary year. This is no longer the case and we believe the improved balance sheet and fundamental prospects justify a multiple closer to the peer group. The peer group is selling at a PE ratio of 9.4. Allowing for a 15% discount, we determine a value of \$45 (8 PER times \$5.64 '05 EPS estimate).

Comparative Valuation of Selected Refining Stocks										
	Price (\$)	12 Month Range (\$)		Mkt Cap	EPS '03	EPS '04	EPS '05	• EPS "'04-'05	PER '05	Ent Value /EBITDA
	10/15/04	Low	High	(\$ Billion)	(\$/sh)	(\$)	9/24/04	(%)	(X)	(ttm)
MRO	40.2	27.75	40.28	14.02	3.33	3.82	3.64	-4.7%	11.0	4.5
VLO	40.91	19.2	44.11	10.8	2.54	5.57	4.28	-23.2	9.6	5.5
AHC	87.41	46.09	88.09	7.83	5.59	9.14	6.98	-23.6%	12.5	5.7
SUN	72.62	40.35	78.03	5.47	4.32	6.96	6.1	-12.4%	11.9	5.7
*PCO	38.98	21.85	40.83	3.43	1.69	4.49	4.26	-5.1%	9.2	7.6
*TSO	29.53	8.05	31.70	1.98	1.71	6.32	5.86	-7.3%	5.0	3.6
FTO	22.97	13.91	22.46	0.63	0.73	2.46	2.16	-12.2%	10.6	5.3
SAMPLE AVERAGES						6.23	5.27	-12.8%	9.4	5.4

*PCO Estimates are by the analyst; Other sample company's data are as per consensus from Yahoo! Finance/First Call

Discounted Cash Flow (DCF) Analysis

We conducted a DCF based valuation using our BASE CASE assumptions of volumes, margins, capex and free cash flow. The critical driver is the crack spread both nationally and in California. We developed financial models for the gross margins of the two operating segments (California and Non-California refineries) based on Gulf Coast crack spreads (see Methodology). We have observed that the ratio of WTI to Gulf Coast 2/1/1/ spread is mean reverting over time about a ratio of 8 over the last

five years (WTI of \$40/8 = \$5 Gulf Coast spread). An increasing ratio means refining margins do not keep up with crude. In the last two years the ratio has been declining meaning refining margins have increased relative to crude. Our BASE CASE starts with current NYMEX futures prices of light sweet crude, discount that by 10%, apply these factors and derive gross margins separately for the California and non-California refineries A fair value of \$46 is calculated using a 12.7% discount rate.

All figures are in \$mn except EPS, Crack Spread and Net Ref. Margin	FY '04 E	FY '05E	FY '06E	FY '07E	FY '08E
Gulf Coast 2/1/1 Crack Spread,\$/B	6.14	6.10	6.05	5.76	5.43
Net Refining Margin, \$/B	6.69	6.72	6.69	6.11	5.47
Net Profit After Tax	431.9	396.3	408.5	312.4	228.0
Add Dep and Amort	151.2	172.1	195.4	238.7	251.6
Change in Working Capital	20.6	(6.1)	(25.1)	32.6	17.9
Mandatory & Maintenance Capex	(187)	(175)	(125)	(125)	(125)
Gasoline Low Sulfur	(10)	(6)	(18)	(4)	0
Diesel Low Sulfur	(20)	(33)	(1)	0	0
Other Environmental	(24)	(19)	(2)	0	0
Sub Total Capex	(241)	(233)	(146)	(129)	(125)
(i) Free Cash Flow	363	329	433	455	372
(ii) NPV of Free Cash Flow @ 12.7%	1,370				
(iii) Terminal Value (0% growth)	2,933				
(iv) PV of Terminal Value	1,818				
(ii) + (iv) Total Present Value of Equity	3,188				
Fully Diluted Shares Outstanding	70				
Estimated Fair Value, \$/share	\$46				

Scenario Analysis

We postulated several alternative scenarios to determine the effect on the calculated DCF value

Scenario I- Cyclical Correction. Margins revert to 2003 values by 2006. Assumes WTI falls to \$35 in '06 and the WTI/Gulf coast spread reverts to 8.0 times so margins decline even more to \$4.38 (vs current \$6.14). The Estimated Fair Value is then \$23, well below current levels. This is in line with 'mid cycle' WTI and margin logic which not unreasonable, but we believe is inappropriate as already discussed.

Scenario II- Golden Age-Regular. Assumes WTI and margins follow the BASE CASE for '05 and '06 but in 2007 revert to the 'mid - cycle' vales of Scenario I. This increases the Fair Value to \$30, the current price.

The huge disparity in values calculated (\$23 to \$46/share) shows the problem in DCF calculations but also the sensitivity to key assumptions. It is quite likely investors will be reluctant to 'pay up' for sustained high margins but remain forever skeptical that they will fall 'next year'. Regardless, we can expect price appreciation due to ongoing earnings growth, if not multiple expansion.

Acquisition Case

A strategic player would see all of the financial merits noted above plus additional benefit from control of crude oil sourcing and assured outlets for their production. TSO buys 250,000 BPD (91.2 million BPY) heavy crude. Saudi heavy sour currently sells at a \$7/B discount to light crude. By integrating forward a heavy oil producer could minimize price discounting to place this large volume of oil. Assuming an avoided discount of \$1/B this is \$90 million avoided cost savings per year. The present value of this over 20 years at 5% is \$1 billion or about \$15/share *premium* to the current quotation. This is a 50% premium to the current price. Most recent acquisitions have been of stand-alone refineries that are worth far less than strategic control of a going business. In March of 2003 Frontier Oil (FTO) and Holly Corporation (HOC) agreed to a merger in which HOC was affectively acquired by FTO at a 31% premium to the current market price. This valued HOC at an EV/EBITDA multiple of 2.9 based on the current share prices at the time. HOC had practically zero net debt at the time (a situation TSO could face in 3 years at current rates). Apparently problems developed and the acquisition failed. The parties are suing each other for damages and a final court decision is expected at any time. HOC shareholders are happy since in the interim their price has doubled and now trades at an EV/EBITDA ratio of 4.3. A control premium of 30% is on the low end of historical ranges and apparently upon further consideration was not enough for HOC. Applying a 40% control premium to the current price gives \$42/share value (\$12/share premium; close to the rough \$15/share synergy premium to a strategic player).

Valuation Summary

	<u>TSO, \$/share</u>	
EV/EBITDA Multiple (4.6 times)	\$33	15% peer group discount
05 P/E Multiple (8 times)	\$45	15% peer group discount
DCF Fair Value	\$38	Avg. of BASE CASE and
Scenario I		
Acquisition by Strategic Player	\$43	Avg. of 40% or \$15/share premium

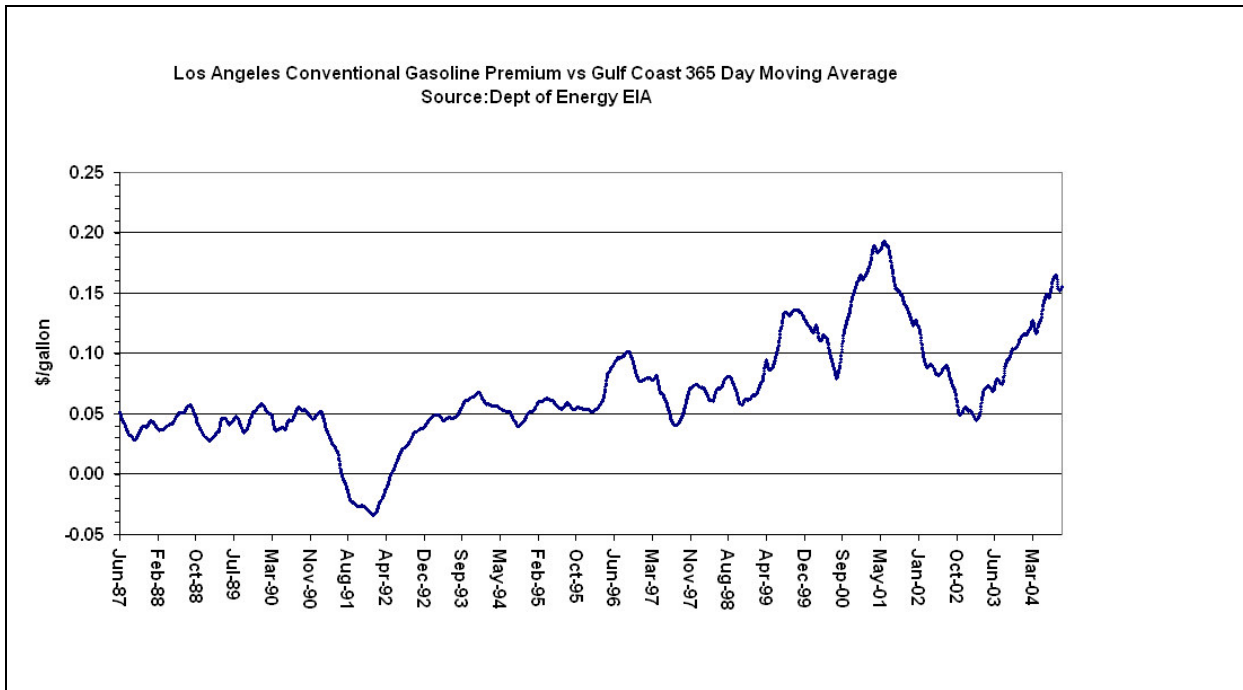
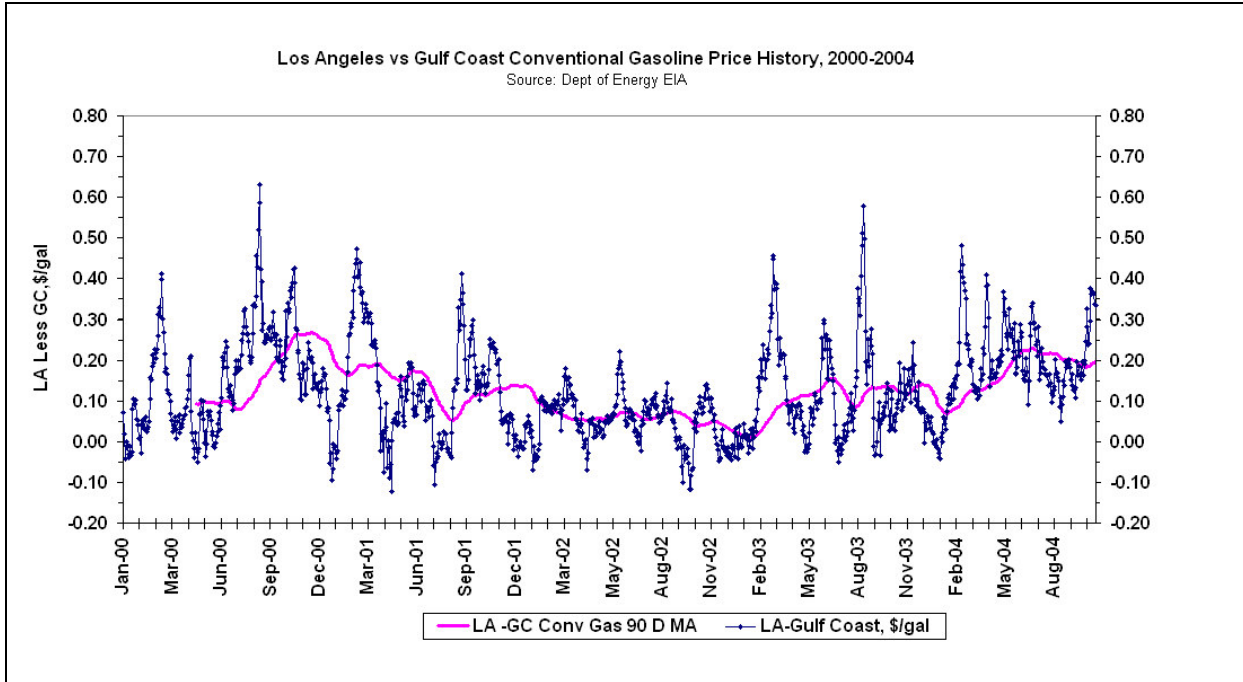
Conclude. An average of the above four methods is \$40. Ignoring the DCF and acquisition case and averaging the two multiple based values gives \$38 at 15% discount to the peer group. This increases to \$48 if the peer group multiples discount is eliminated.

Methodology

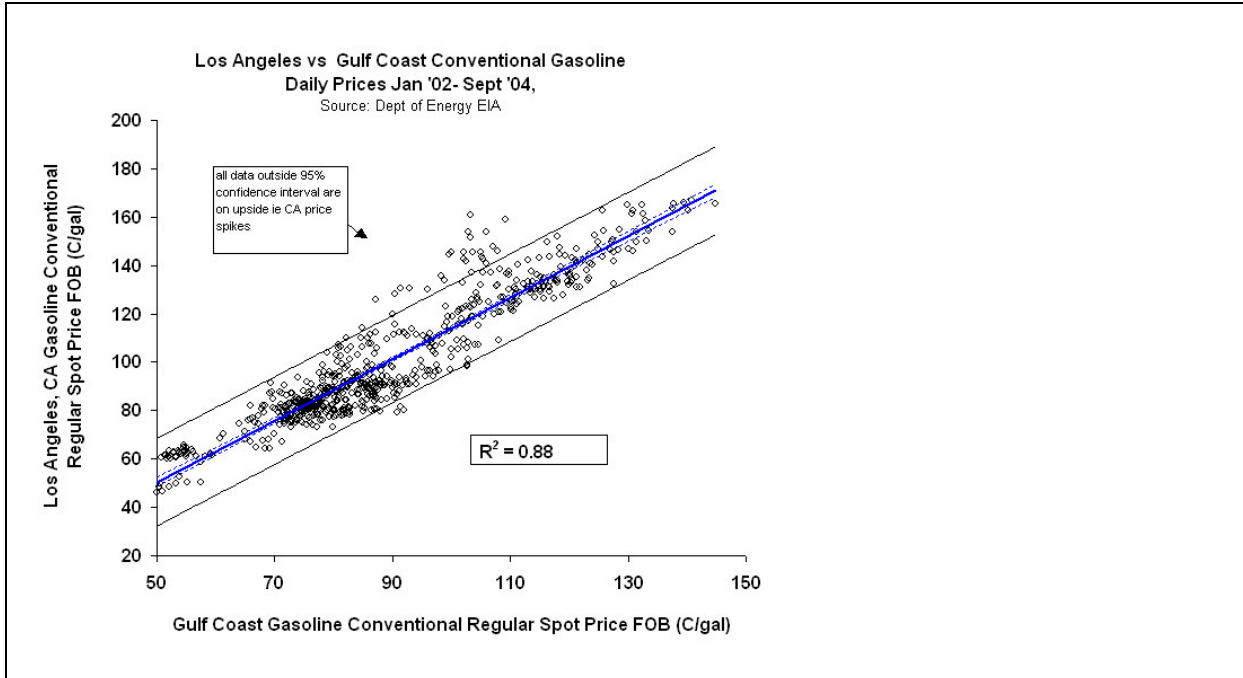
The 6 refineries were classified as California (40% gross margin) and non-California (remaining 5 are 60% of margin) and gross margins compared to Gulf Coast 2/1/1 over time. We regressed the observed margins as a function of WTI and Gulf Coast spread. This enables use of NYMEX futures markets implied New York Harbor crack spreads which we have modeled to Gulf Coast margins and from there developed estimates for TSO CA and no-CA margins.

The California gross margin model was built up from the conventional gasoline premium of Los Angeles vs Gulf Coast over the last 20 years. This premium averaged 13 cents/gal from 1990-2001, but has increased to 19 cents since then. A 365-day moving average of the premium smoothes out these spikes revealing an important observation: the spikes are increasing in frequency but are not a new phenomenon. The decline in 2002 was due to the recession and an obviously soft market.

[Insert Fig 3 Key Charts](#)

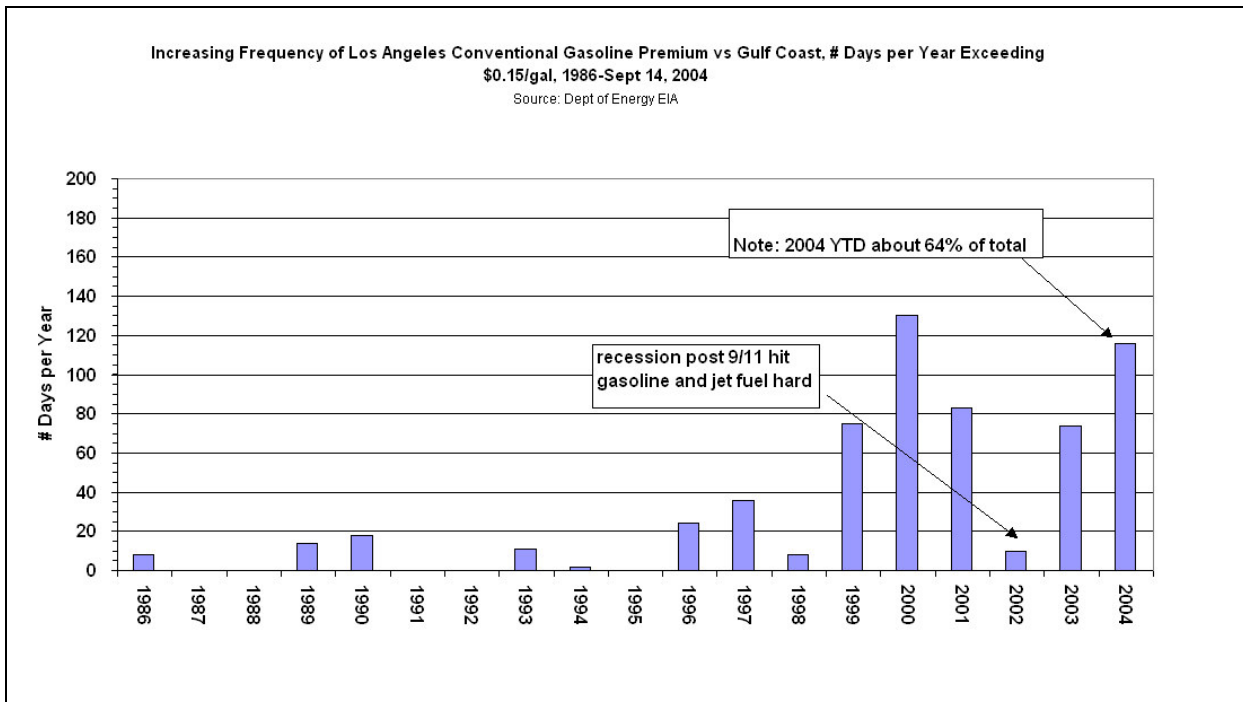


A linear regression of the data indicates a very strong correlation between the Gulf Coast and Los Angeles conventional gasoline price. The differential averaged 13 cents/gal from 1990 to 2001, and 19 cents/gallon since then. This difference between the two premiums is statistically significant at the .005 level (99.5% confidence the difference in premiums is not due to chance, $t = 2.97$). The explanation is the increasing frequency and magnitude of price spikes due to operating upsets, product supply limitations including change over to ethanol from MTBE as an oxygenate. In addition base stock costs have increased due to reformulation and regulatory requirements.



Regression Analysis of Los Angeles vs Gulf Coast Gasoline Prices, Daily Prices 2002-2004 Source: Dept of Energy EIA (Call 203-355-0500 for more info)

Although ethanol is well established now, the general supply/demand conditions causing these spikes remain in place. These are not fixable short term and short of a recession will continue. See “2003 California Gasoline Price Study, Final Report” November 2003 Energy Information Administration, Department of Energy for a thorough discussion of this issue.



The California crack spread model is derived from a proprietary model using the prior regression analysis of Los Angeles vs Gulf Coast gasoline premium plus and our estimates of West Texas Intermediate and Gulf Coast crack spreads. Detail provided upon request. The modeled prices are back tested against recent actuals and fit quite closely as shown in Figure 4.

The non-California refinery margins were modeled against the Gulf Coast 2/1/1 spread and projections made accordingly.

Asset Overview

Refining

- **Martinez, CA** 168,000 BPD, complex refinery runs heavy crude from Alaskan North Slope. Acquired from Ultramar, 2002 that were forced to sell by the FTC as a condition to their merger with Valero. Ultramar acquired it in 2001 from Tosco. Prior owners had made substantial capital investments to meet California environmental standards. A fire broke out October 14, 2004 but was extinguished without loss of life, or production.
- **Anacortes, WA** 108,000 BPD heavy crude feed. Connected to Canadian crude supply via pipeline.
- **Kenai, AK** 72,000 BPD modern refinery runs light, sweet crude. Supplies jet fuel to the Anchorage, Alaska airport, a major transportation hub connecting the US and Far East, via pipeline.
- **Kapolei, HI** 95,000 BPD refinery, runs heavy crude. Major customers are US Military (bunker and jet fuel) for Navy and Air Force.
- **Mandan, ND** 60,000 BPD refinery acquired from BP in 2001. Runs light sweet crude.
- **Salt Lake City, UT** 55,000 BPD refinery acquired from BP in 2001. Runs light sweet crude.
- Throughput is 58% heavy crude. Refining is 90% of total PP&E (remainder are retail stations).

Retail

About 15% of gasoline production is sold through branded operations under the name Tesoro[®] and Mirastar[®]. TSO owns and operates 226 stations and independent jobbers operate 331. The remainder of production is sold through wholesale channels.

Risks

- **Price:** The Company is un-diversified both product wise and geographically. Raw materials and production are commodities and management has no control over either. TSO is smaller than many of its competitors. Industry fundamentals are favorable over the next 2-3 years (see Premcor PCO-Buy report for more information) in our opinion. A decline in refining margins could occur if supplies increase dramatically (most likely from imports) or demand declines significantly either in the US or in China and other Developing Countries.
- **Operational:** TSO has 6 refineries but 30% of throughput and over 40% of gross profit comes from the Golden Eagle Refinery in CA. A major problem resulting in extended shutdowns could be very detrimental to earnings.
- **Macroeconomic:** Demand for refined products in the Far East has bid up the price of imports into the US and lifted refining margins. A downturn or slow down of this growth could release additional volumes for the US and reduce margins and profit.

- **Weather:** Demand is very seasonal with heating oil needed in the winter and gasoline in the spring and summer. An unusually warm winter would reduce demand and margins.

Political

- **China:** Any political event in the country or region (terrorism, confrontation with North Korea, currency revaluation, civil unrest) could hurt local demand and create a cascade effect on US refining margins.
- **California:** TSO gets at least 40% of gross profits from California and any move on the part of the State to increase taxes, regulations, emissions or other action could have a serious consequence.
- **Environmental:** TSO is in good shape to meet current EPA requirements but new regulations could be introduced harming the petroleum industry. TSO and most other refiners have been sued for groundwater contamination with MTBE, an oxygenate added to gasoline to reduce toxic emissions. The Congress has considered an MTBE liability exemption as part of the Energy Bill but that failed to pass in the last Congress.

Tesoro - Key Forecast Assumptions

Q1 ' 0: Q2 ' 0: Q3 ' 0: Q4 ' 0: FY ' 0: Q1 ' 0: Q2 ' 0: Q3 ' 04 | Q4 ' 04 | FY ' 04 | FY ' 05 | FY ' 06 | FY ' 07 |

Operations

Non- CA Capacity, KBPD	390	390	390	390	390	390	390	390	390	390	390	390	390
CA Capacity, KBPD	168	168	168	168	168	168	168	168	168	168	168	168	168
Non-CA Throughput, % Nameplate	78.7%	86.7%	89.0%	86.2%	85.1%	88.5%	96.4%	94.0%	67.0%	86.5%	88.0%	90.0%	90.0%
CA Throughput, % Nameplate	94.0%	94.6%	94.0%	88.7%	92.9%	91.1%	96.4%	94.0%	67.0%	87.1%	85.0%	94.0%	94.0%
Non-CA Throughput, M B	28.0	30.8	31.7	30.7	121.2	31.5	34.3	33.5	23.8	123.1	125.3	128.1	128.1
CA Throughput, M B	14.4	14.5	14.4	13.6	56.9	14.0	14.8	14.4	10.3	53.4	52.1	57.6	57.6
Total Crude Throughput M B	42.4	45.4	46.1	44.3	178.1	45.4	49.1	47.9	34.1	176.5	177.4	185.8	185.8
Total Capacity Utilization,%	83.3%	89.1%	90.5%	86.9%	87.5%	89.2%	96.4%	94.0%	67.0%	86.7%	87.1%	91.2%	91.2%

Margins

WTI, \$/B	34.10	28.98	30.21	31.19	31.12	35.24	38.35	43.87	51.74	42.30	44.53	44.18	42.02
WTI/GC Spread, \$/B	6.19	7.94	6.04	7.95	6.69	6.18	5.15	7.22	9.71	6.89	7.30	7.30	7.30
Gulf Coast 2/1/1, Spread, \$/B	5.51	3.65	5.01	3.92	4.65	5.71	7.44	6.08	5.33	6.14	6.10	6.05	5.76
Non-CA Gross Margin, \$/B	5.05	4.42	6.89	4.98	5.35	6.01	10.48	7.52	6.46	7.60	7.55	7.48	7.06
CA Gross Margin, \$/B	10.56	9.08	11.19	7.58	9.63	11.10	19.51	14.29	15.45	13.94	14.49	14.33	13.38
Total Gross Margin	6.95	5.89	8.18	5.81	6.71	7.66	13.02	9.56	9.17	9.52	9.59	9.61	9.02

Non-CA Mfg Cost, \$/B	2.12	1.96	2.11	2.32	2.13	2.12	2.03	2.03	2.05	2.05	2.10	2.10	2.10
CA- Mfg Cost, \$/B	4.27	4.58	4.39	4.40	4.41	4.61	4.63	4.63	4.68	4.64	4.73	4.73	4.73
Total, \$/B	2.90	2.80	2.80	2.96	2.85	2.88	2.83	2.81	2.84	2.84	2.87	2.91	2.91

Wtd avg Full Diluted Shares Out, mil	64.7	64.7	64.9	65	65.1	67.3	68.6	68.7	68.8	68.35	70	70	70
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Tesoro Earnings Model, \$mil

Gross Refining Margin	295.3	267.7	377.0	257.0	1,196.0	348.0	639.0	457.4	312.7	1,680.7	1,700.9	1,784.5	1,675.8
% Gross Margin- CA	51.6%	49.2%	42.8%	40.1%	45.8%	44.5%	45.1%	45.0%	50.8%	44.3%	44.4%	46.3%	46.0%
Mfg Costs	121.1	126.5	130.0	131.0	509.4	130.9	138.9	134.5	96.9	500.6	509.0	541.1	541.1
Other Expenses	27.0	32.5	35.0	34.5	129.0	29.0	35.0	35.0	35.0	134.0	138.0	142.2	146.4
Sales, General and Admin	8.0	6.8	6.0	6.2	27.0	5.0	6.4	6.4	6.4	24.2	24.9	25.7	26.4
Depreciation And Amortization	30.0	29.6	29.5	30.9	120.0	31.0	31.8	31.8	31.8	126.4	149.1	172.4	215.7
Refining Operating Income	109.2	72.3	176.5	52.6	410.6	151.6	426.9	249.7	142.7	895.5	879.8	903.1	746.1

Retail Gross Margin	23.0	40.9	37.0	35.1	136.0	26.0	28.4	28.0	28.4	110.8	112.0	112.0	112.0
Retail Op expenses	26.0	25.6	25.0	24.4	101.0	26.0	25.5	22.0	22.0	95.5	94.0	94.0	94.0
Retail Depreciation	5.0	5.0	4.7	4.3	19.0	4.0	4.4	4.4	4.4	17.2	16.0	16.0	16.0
Retail Operating Income	(8.0)	10.3	7.3	6.4	16.0	(4.0)	(1.5)	1.6	2.0	(1.9)	2.0	2.0	2.0
Corporate Expense	19.5	12.5	12.4	22.1	66.5	18.2	24.4	30.0	25.0	97.6	100.5	103.5	106.7
Corporate Depreciation	2.0	2.1	2.5	2.4	9.0	2.0	1.6	2.0	2.0	7.6	7.0	7.0	7.0
Loss on Asset Sale	0.2	0.9	9.2	5.7	16.0	0.6	3.5	0.0	0.0	4.1	4.0	4.0	4.0
Operating Income	79.5	67.1	159.7	28.8	335.1	126.6	395.9	219.3	117.7	784.3	770.2	790.6	630.5
Net financing costs and Interest	47.0	78.2	45.9	40.6	211.7	42.9	40.2	29.3	27.4	139.8	109.8	109.8	109.8
Earnings Before Tax	32.5	(11.1)	113.8	(11.8)	123.4	83.7	355.7	190.0	90.2	644.5	660.5	680.8	520.7
Income Tax Provision(benefit)	12.1	(4.1)	43.1	(4.1)	47.0	33.3	142.4	76.0	36.1	287.8	264.2	272.3	208.3
Net Income	20.4	(7.0)	70.7	(7.7)	76.4	50.4	213.3	114.0	54.1	431.9	396.3	408.5	312.4
EPS, fully diluted	0.32	(0.11)	1.09	(0.12)	1.17	0.75	3.11	1.66	0.79	6.32	5.66	5.84	4.46

Tesoro Cash Flow Model, \$mil

Cash Flow from Operating Activities

	Q1 ' 00	Q2 ' 00	Q3 ' 00	Q4 ' 00	FY ' 00	Q1 ' 01	Q2 ' 01	Q3 ' 04	Q4 ' 04	FY ' 04	FY ' 05	FY ' 06	FY ' 07
Net Income	20.4	(7.0)	70.7	(7.7)	76.4	50.4	213.3	114.0	54.1	431.9	396.3	408.5	312.4
Depreciation and Amortization	37.0	36.7	36.7	37.6	148.0	37.0	37.8	38.2	38.2	151.2	172.1	195.4	238.7
Deferred Tax and non-cash expense	30.1	34.6	34.7	(14.1)	85.3	44.1	87.4	40.0	40.0	211.5	0.0	0.0	0.0
Change in Working Capital	(80.3)	209.7	(53.6)	61.9	137.7	(78.2)	0.9	54.5	43.4	20.6	(6.1)	(25.1)	32.6
Operating Cash Flow	7.2	274.0	88.5	77.7	447.4	53.3	339.4	246.7	175.7	815.1	562.3	578.8	583.7

Investing Activities

CapEx, ex Environmental					126.0	8.0	14.0	30.0	35.0	87.0	75.0	75.0	75.0
CapEx Environmental					26.0	7.0	17.0	8.0	8.0	40.0	58.0	21.0	4.0
Maintenance & Other				(31.0)		25.0	25.0	25.0	25.0	100.0	100.0	50.0	50.0
Total Capex	26.0	15.8	21.2	63.0	152.0	40.0	56.0	63.0	68.0	227.0	233.0	146.0	129.0
Free Cash Flow (Operating less Investing)	(18.8)	258.2	67.3	14.7	295.4	13.3	283.4	183.7	107.7	588.1	329.3	432.8	454.7

Cash Flow -Financing

Other Cash (source) Use		80.0	4.0	25.8	109.8	1.0	7.0						
Net Debt Repayment	76.6	123.5	122.9	2.0	325.0	(2.0)	(5.0)	397.0	0.0	390.0	0.0	0.0	0.0

Summary Capital Structure

Cash & Equivalents-end period	14	68	9	27	27	41	322	109	217	217	546	979	1,434
Total Debt	1,854	1,730	1,607	1,605	1,605	1,607	1,612	1,215	1,215	1,215	1,215	1,215	1,215

Shareholders Equity	908	901	972	964	964	1,021	1,242	1,363	1,424	1,863	2,266	2,681	3,001
Total Debt + Equity	2,762	2,631	2,579	2,569	2,569	2,628	2,854	2,578	2,639	3,078	3,481	3,896	4,216
Total Debt to Total Capitalization	67.1%	65.8%	62.3%	62.5%	62.5%	61.1%	56.5%	47.1%	46.0%	39.5%	34.9%	31.2%	28.8%
Net Debt to Total Capitalization	66.6%	63.2%	62.0%	61.4%	61.4%	59.6%	45.2%	42.9%	37.8%	32.4%	19.2%	6.1%	0.0%
EBITDA	117	104	196	66	483	164	434	257	156	935	942	986	869
Stock Price,\$/sh end period	7.4	6.88	8.46	14.81	14.81	18.79	27.6	29.53	29.53	29.53	29.53	29.53	29.53
EV/EBITDA,ttm	12.2	8.3	5.5	5.4	5.4	5.3	3.7	3.4	3.0	3.0	2.9	2.3	2.1

Tesoro Dollars per Barrel Analysis

\$/B Analysis	Q1 ' 00	Q2 ' 00	Q3 ' 00	Q4 ' 00	FY ' 00	Q1 ' 01	Q2 ' 01	Q3 ' 01	Q4 ' 01	FY ' 01	FY ' 05	FY ' 06	FY ' 07
GM/B throughput	6.96	5.90	8.18	5.81	6.71	7.66	13.02	9.56	9.17	9.52	9.59	9.61	9.02
Operating Expense	2.85	2.79	2.82	2.96	2.86	2.88	2.83	2.81	2.84	2.84	2.87	2.91	2.91
Net Refining Margin	4.11	3.11	5.36	2.85	3.85	4.78	10.19	6.75	6.33	6.69	6.72	6.69	6.11
SG&A& Other	0.65	0.43	0.40	0.64	0.52	0.51	0.63	0.76	0.92	0.69	0.71	0.70	0.72
Net Income	0.48	(0.16)	1.53	(0.17)	0.43	1.11	4.34	2.38	1.59	2.45	2.23	2.20	1.68
Throughput, B/share (p.a.)	2.62	2.80	2.84	2.72	2.74	2.70	2.86	2.79	1.98	2.58	2.53	2.65	2.65

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Clay Mahaffey, Level III Candidate in CFA Program, has worked with Investors Capital Management, Inc., and also as an independent equity analyst with Pittsburg Research covering chemical and energy stocks. His initial career with Exxon Chemical in engineering and technical assignments and later, sales and marketing enabled him to develop deep insight into integrated energy operations. He conducted merger and acquisition services for The Sterling Group and led an LBO program targeting a segment of the specialty chemical industry for a Boston based financial service firm. Mr. Mahaffey has a BS in Chemical Engineering from LSU and an MBA from The Wharton School, University of Pennsylvania.

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INVESTOLOGY INC. www.investologyinc.net 203-355-0500; 703-636-4300
Research@investologyinc.net