Fourth Quarter 2016 Earnings Conference Call

Tuesday, January 31, 2017, 9:00 a.m. CT

Introduction – John Locke

- Good morning and welcome to Valero Energy Corporation's fourth quarter 2016 earnings conference call.

- With me today are Joe Gorder, our Chairman, President, and Chief Executive Officer; Mike Ciskowski, our Executive Vice President and CFO; Lane Riggs, our Executive Vice President of Refining Operations and Engineering; Jay Browning, our Executive Vice President and General Counsel; and several other members of Valero's senior management team.

- If you have not received the earnings release and would like a copy, you can find one on our website at valero.com. Also, attached to the earnings release are tables that provide additional financial information on our business segments. If you have any questions after reviewing these tables, please feel free to contact our Investor Relations team after the call.

- I would like to direct your attention to the forward-looking statement disclaimer contained in the press release. In summary it says that . . .
- Statements in the press release and on this conference call that state the company's or management's expectations or predictions of the future are forward-looking statements intended to be covered by the safe-harbor provisions under federal securities laws. There are many factors that could cause actual results to differ from our expectations, including those we've described in our filings with the SEC.
- Now I will turn the call over to Joe for a few opening remarks.

Joe Gorder

- Thanks John and good morning everyone. The fourth quarter and the full-year 2016 were good for Valero as we achieved our best performance ever in the areas of personnel and process safety, plant reliability, and environmental stewardship. We are very proud of our team's exceptional execution, which we believe is imperative in our business and critical during a low margin environment like we saw for most of the year.

- In the fourth quarter, we continued to see good domestic demand supported by low prices and solid export volumes due primarily to demand strength in Latin America. While we saw seasonal declines in available margin in some regions, margins in the Gulf Coast region remained healthy and distillate margins in all regions were bolstered by a return to more normal weather patterns in North America and Europe. We also saw attractive heavy sour discounts relative to Brent.

- A persistent headwind again this quarter was the exorbitant price of RINs. We spent $217 million in the fourth quarter to meet our biofuel blending obligations.

- At this level, this is a significant issue for us, so we continue to work it aggressively with regulators. Our efforts are focused on moving the point of obligation because we believe this will level the playing field among refiners and retailers, but more importantly it will improve the penetration of renewable fuels, lower RIN speculation, and reduce RIN fraud. However, based on the current rules, we expect costs in 2017 to be similar to the $750 million amount we incurred last year. Given the significance of this cost to our company, this issue continues to have our full attention.

- Turning to our refining segment, we initiated turnarounds at our Port Arthur and Ardmore refineries in the third quarter. Both events carried over into and were completed in the fourth quarter. Our employees and contractors worked hard to safely complete these events. We believe distinctive operating performance is highly correlated to capturing more of the margin available in the market.

- In our ethanol business, we ran very well and saw strong margins in the fourth quarter due to high gasoline demand in the US, strong pull from the export markets, and low corn prices.

- Also in the fourth quarter, we invested over $600 million to sustain and grow our business. Construction continued on our $450 million Diamond Pipeline project, which we believe is on track for completion at the end of this year, and we continued to work on our $300 million Houston alkylation unit, which we expect to be mechanically complete in the first half of 2019. We also have additional growth investment opportunities under development around octane enhancement, cogeneration, and feedstock flexibility.

- And finally, regarding cash returns to stockholders, we delivered a payout ratio of 142 percent of our 2016 adjusted net income, which was 78 percent higher than our payout ratio for 2015 and well above our target for 2016. Further demonstrating our belief in Valero's earnings power, last week our Board of Directors approved a 17 percent increase in the regular quarterly dividend to 70 cents per share, or $2.80 annually.

- So with that, John, I'll hand the call back to you.

John Locke

- Thank you Joe. For the fourth quarter, net income attributable to Valero stockholders was $367 million, or $0.81 per share, compared to $298 million, or $0.62 per share, in the fourth quarter of 2015. Fourth quarter 2015 adjusted net income attributable to Valero stockholders was $862 million, or $1.79 per share.

- For 2016, net income attributable to Valero stockholders was $2.3 billion, or $4.94 per share, compared to $4.0 billion, or $7.99 per share, in 2015. 2016 adjusted net income attributable to Valero stockholders was $1.7 billion, or $3.72 per share, compared to $4.6 billion, or $9.24 per share, for 2015. Please refer to the reconciliations of actual to adjusted amounts as shown on page three of the financial tables that accompany our release.

- Operating income for the refining segment in the fourth quarter of 2016 was $715 million, compared to $876 million for the fourth quarter of 2015. Adjusted operating income for the fourth quarter of 2015 was $1.5 billion. The decline from the 2015 adjusted amount was primarily due to narrower discounts for most sweet and sour crude oils relative to Brent, weaker gasoline margins in some regions, and higher RINs prices.

- Refining throughput volumes averaged 2.9 million barrels per day, which was in line with the fourth quarter of 2015. Our refineries operated at 95 percent throughput capacity utilization in the fourth quarter of 2016, with major turnarounds at the Port Arthur and Ardmore refineries completed early in the quarter.

- Refining cash operating expenses of $3.83 per barrel were $0.36 per barrel higher than the fourth quarter of 2015, primarily due to favorable property tax settlements and adjustments in 2015, and higher energy costs in 2016.

- The ethanol segment generated $126 million of operating income in the fourth quarter of 2016 compared to a loss of $13 million in the fourth quarter of 2015. Adjusted operating income for the fourth quarter of 2015 was $37 million. The increase from the 2015 adjusted amount was due primarily to lower corn prices and higher ethanol prices.

- For the fourth quarter of 2016, general and administrative expenses excluding corporate depreciation were $208 million, and net interest expense was $112 million. Net interest expense was lower than guidance due to prepayment penalties associated with the early redemption of the 2017 notes being reflected in other income.

- Depreciation and amortization expense was $468 million, and the effective tax rate was 21 percent in the fourth quarter of 2016. The effective tax rate was lower than expected due primarily to stronger than projected relative earnings contribution from our international operations that have lower statutory rates and other items as referenced in the release.

- With respect to our balance sheet at quarter-end, total debt was $8.0 billion, and cash and temporary cash investments were $4.8 billion, of which $71 million was held by VLP. Valero's debt-to-capitalization ratio, net of $2 billion in cash, was 23 percent. We had $5.6 billion of available liquidity excluding cash, of which $720 million was available for only VLP.

- We generated $998 million of cash from operating activities in the fourth quarter.

- With regard to investing activities, we made $628 million of capital investments, of which $244 million was for turnarounds and catalyst. For 2016, we invested $2 billion, which was slightly lower than guidance due to lower turnaround costs and the timing of some growth spend, and of this total, $1.4 billion was for sustaining and $600 million was for growth.

- Moving to financing activities, we returned $440 million in cash to our stockholders in the fourth quarter, which included $271 million in dividend payments and $169 million for the purchase of 2.7 million shares of Valero common stock. For 2016, we purchased 23.3 million shares for $1.3 billion and had approximately $2.5 billion of authorization remaining.

- For 2017, we maintain our guidance of $2.7 billion for capital investments, including turnarounds, catalyst, and joint venture investments. This consists of approximately $1.6 billion for sustaining and $1.1 billion for growth.

- For modeling our first quarter operations, we expect throughput volumes to fall within the following ranges: U.S. Gulf Coast at 1.63 million to 1.68 million barrels per day; U.S. Mid-Continent at 415 thousand to 435 thousand barrels per day; U.S. West Coast at 195 thousand to 215 thousand barrels per day, which reflects a major turnaround at the Benicia refinery; and North Atlantic at 440 thousand to 460 thousand barrels per day.

- We expect refining cash operating expenses in the first quarter to be approximately $4.15 per barrel, which reflects projected increased natural gas prices.

- Our ethanol segment is expected to produce a total of 3.8 million gallons per day in the first quarter. Operating expenses should average 39 cents per gallon, which includes five cents per gallon for non-cash costs, such as depreciation and amortization.

- We expect G&A expenses, excluding corporate depreciation, for the first quarter to be around $175 million, and net interest expense should be about $115 million. Total depreciation and amortization expense should be approximately $485 million, and our effective tax rate is expected to be around 30 percent.

- That concludes our opening remarks. Before we open the call to questions, we again respectfully request that callers adhere to our protocol of limiting each turn in the Q&A to two questions. This will help us ensure other callers have time to ask their questions. If you have more than two questions, please re-join the queue as time permits.

Operator Facilitated Q&A

John Locke

- We appreciate you joining us today. Please contact me if you have any additional questions. Thank you.