First Quarter 2016 Earnings Conference Call

Tuesday, May 3, 2016, 10:00 a.m. CT

Introduction – John Locke

• Good morning and welcome to Valero Energy Corporation’s first 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 first quarter presented us with challenging markets, with gasoline and diesel margins under pressure for most of the quarter. The bright spot was the performance of our team, as we continued to operate safely and reliably. What I’d like to do this morning is take a few minutes to discuss our strategic initiatives that we believe will continue to drive long term value creation, and then share some color on what we’re seeing in the markets.

- First, and at the core of everything we do, is a relentless focus on safety and reliability. Our dedication and persistence here is what keeps our people and communities safe, our operations reliable, and our cash operating costs the lowest in the peer group. Having low cash cost operations is a major advantage in our industry where product margins can be quite volatile. As a disciplined operator, we are able to run profitably in a lower-margin environment as experienced in the first quarter.
• Second, we apply discipline and rigor as we evaluate and execute investments that will grow the profitability and competitiveness of our business for many years. The strategic plan that was approved by our board of directors last year included $2.6 billion of capital spending for 2016. Approximately $1 billion was allocated to strategic investments to drive long-term earnings growth.

• Third, we’re committed to delivering value to stockholders by making the right investments in our business and returning cash. We demonstrated this in 2015 when we delivered the highest total stockholder return among our peers for both Valero and VLP. We expect VLP to continue to be well positioned to execute its distribution growth strategy through 2017 despite volatile capital markets.

• We also continue to keep an eye on M&A. We review opportunities and we have a list of targets that we consistently monitor. We consider M&A a discretionary use of cash, so there is healthy tension when evaluating M&A opportunities versus other alternative uses. Of course we can’t comment specifically on M&A, but we are diligently reviewing opportunities.
• For cash returns in 2016, which is made up of dividends and buybacks, we’ve extended our 2015 payout target of 75 percent of net income. In January, we increased the quarterly dividend by 20 percent to $0.60 per share, and we remain focused on maintaining a dividend payout at the high end of our peer group. We’re confident in Valero’s ability to fund investments in future growth and to meet its payout target.

• Lastly, let me share some color on the current market. Already this year there’s been a lot of conversation about various market topics including gasoline demand resurgence, octane strength, diesel length, domestic crude supply, and crude storage levels.

• As you know, markets for Valero’s feedstocks and products are dynamic. Our high-complexity refineries, system flexibility, advantaged location, and low cash cost operations, enables us to maximize earnings under changing market conditions.

• On the crude supply side, we’re seeing more medium sour crudes coming into the market. As a result, we’re seeing healthy medium and heavy sour crude discounts. We also have greater access to domestic sweet crudes, with the logistics build-out in the U.S. allowing domestic production to clear the Mid-Continent region and reach the large Gulf Coast refining center.
• On the demand side, continued GDP growth and low product prices should continue to support demand.

• In the U.S., we’ve seen gasoline demand continue to grow. We’re encouraged by increased vehicle miles traveled and double digit percentage increases in SUV and truck purchases in the U.S. and key countries around the globe.

• Distillate demand globally was good, despite fairly flat demand in the U.S. While distillate margins were pressured near term due to unseasonably warm weather in North America and Europe, distillate demand in Latin America remains robust.

• Overall, we still have structural refined product supply challenges in South America and the developing countries, which we don’t expect to be resolved in the near term. With our low-cost Gulf Coast refining presence, we have the ability to compete in markets all over the globe. We also have the opportunity to optimize our system and supply the Atlantic Basin with our refineries in Wales and Quebec City. In fact, we generated another quarter of solid distillate and gasoline export volumes.
• In summary, we still have significant crude supply, ample natural gas availability, and growing global petroleum demand that is outpacing refining capacity additions. We don’t see this changing any time soon. So although the market will be challenging at times, longer term, the macro outlook remains favorable.

• With that, John, I’ll hand the call back to you.

**John Locke**

• Thank you Joe. Moving on to the results, net income was $495 million, or $1.05 per share, for the first quarter of 2016. Excluding an after tax lower of cost or market inventory valuation benefit of $212 million, or $0.45 per share, we reported first quarter 2016 adjusted net income of $283 million, or $0.60 per share. This compares to $964 million, or $1.87 per share, for the first quarter of 2015. For reconciliations of actual to adjusted amounts, please refer to page six of the financial tables that accompany our release.

• Adjusted operating income for the refining segment in the first quarter of 2016 was $695 million, or $946 million lower than the first quarter of 2015. Margins were pressured downward primarily due to weaker distillate margins given high refinery run rates across the industry, product inventory builds, and unseasonably warm weather.
• Other headwinds on refining margins included narrower domestic light sweet crude oil discounts versus the Brent benchmark, low fuel oil and petrochemical product margins, and elevated costs for RINs credits. Low crude oil prices continued to drive slowdowns in North American drilling and production, which coupled with an excess of pipeline takeaway capacity [in the Mid-Continent region] led to tighter discounts for crude oils relative to Brent. Low energy costs supported by robust North American natural gas production partly offset these factors.

• Our refineries operated at 96 percent throughput capacity utilization in the first quarter of 2016, and throughput volumes averaged 2.9 million barrels per day, which was 169,000 barrels per day higher than the first quarter of 2015.

• Refining cash operating expenses of $3.55 per barrel, were $0.40 per barrel lower than the first quarter of 2015, mostly due to higher throughput volumes and lower energy costs.
• The ethanol segment earned $9 million of adjusted operating income in the first quarter of 2016 compared to $12 million in the first quarter of 2015. The low crude oil and gasoline price environment challenged ethanol margins, but with the recent recovery in prices, ethanol margins have modestly improved to start the second quarter.

• For the first quarter of 2016, general and administrative expenses excluding corporate depreciation were $156 million. Net interest expense was $108 million.

• Depreciation and amortization expense was $485 million, and the effective tax rate for the first quarter of 2016 was 30 percent. The effective tax rate was lower than the first quarter of 2015 primarily due to higher relative earnings contribution from international operations with lower statutory tax rates.

• Regarding our balance sheet at quarter-end, we had $7.3 billion of total debt and $3.8 billion of cash and temporary cash investments, of which $102 million was held by VLP. Valero’s debt-to-capitalization ratio, net of $2 billion in cash, was 20 percent. We had $5.5 billion of available liquidity excluding cash, of which $575 million was only available to VLP.
• Cash flows in the first quarter included $479 million of capital investments, of which $161 million was for turnarounds and catalyst. For 2016, we expect to invest $1.6 billion of capital to sustain the business and $1 billion for refining asset optimization and logistics to drive long-term earnings growth.

• With respect to our refining growth strategy, the new Corpus Christi crude unit, which was completed late last year, operated as planned and delivered approximately $35 million of EBITDA in the first quarter. We completed the St. Charles hydrocracker expansion in March and the new Houston crude unit is on track to start up in the second quarter. The Houston alkylation project, which was approved in January, is now undergoing detailed engineering and procurement. Completion of the alkylation unit is expected in the first half of 2019.

• Moving to financing activities, we returned $547 million in cash to our stockholders in the first quarter, which included $282 million in dividend payments and $265 million for the purchase of 3.8 million shares of Valero common stock. We had $1.1 billion of remaining share repurchase authorization as of March 31, 2016. Our regular quarterly cash dividend is now 60 cents per share. We continue to target a payout of 75 percent of annual net income for 2016.
• For modeling our second quarter operations, we expect throughput volumes to fall within the following ranges: Gulf Coast at 1.59 million to 1.64 million barrels per day; Mid-Continent at 430 thousand to 450 thousand barrels per day; West Coast at 260 thousand to 280 thousand barrels per day; and North Atlantic at 450 thousand to 470 thousand barrels per day.

• Refining cash operating expenses are estimated at approximately $3.75 per barrel for the second quarter.

• Based on today’s market prices, we expect costs related to meeting our biofuel blending obligations to be between $750 million and $850 million for 2016. This is primarily related to RINs in the US.

• The ethanol segment is expected to produce a total of 3.8 million gallons per day. Operating expenses should average 37 cents per gallon, which includes five cents per gallon for depreciation and amortization.

• G&A expenses for the second quarter, excluding corporate depreciation, are expected to be approximately $165 million, and net interest expense should be about $110 million. Total depreciation and amortization expense is estimated at $465 million, and our effective tax rate is expected to be 31 percent.
• This concludes our opening remarks. Before we open the call to questions, we respectfully request that callers limit 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 Karen Ngo or me if you have any additional questions. Thank you.