First Quarter 2017 Earnings Conference Call

Tuesday, April 25, 2017, 9:00 a.m. CT

Introduction – John Locke

- Good morning and welcome to Valero Energy Corporation's first quarter 2017 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. Our team again delivered solid operating results and distinctive financial performance during a quarter where we saw heavy maintenance activity and soft margins. Our continued focus on safety and reliability in our plants has been key to our ability to capture the available margin.

- In the first quarter, we saw healthy domestic and export demand for refined products, driven by low prices, seasonal weather conditions in North America and Europe, and a resurgence of domestic oil patch activity. Latin America also continued to be a strong source of demand for gasoline and diesel.

- On the crude supply side, we continued to see rig count increases in the U.S., particularly in the Permian Basin. As production ramps up and more domestic sweet crude makes its way to the Gulf Coast, our refineries in the Mid-Continent and the Gulf Coast are prepared to capture the feedstock opportunities.

- While RINs prices have declined relative to 2016, they were still a significant headwind for the quarter. At this level, RINs expense remains an issue for us, so we continue to work with regulators.

- Turning to our refining segment, in the first quarter we completed a heavy turnaround schedule at our Benicia, Texas City, St. Charles, and Meraux refineries. Our employees and contractors safely executed these projects. With the majority of our planned maintenance for the year behind us, we should be ready to capture available market opportunities.

- In our ethanol business, we had record production volumes for the quarter, as higher ethanol prices and strong demand for ethanol exports supported production rates.

- Also in the first quarter, we invested $641 million of sustaining and growth capital. Construction is progressing on the Diamond Pipeline, with completion expected at the end of this year. Work on the Diamond Green Diesel plant expansion, the Houston alkylation unit, and the Wilmington cogeneration plant, is continuing as planned.

- Turning to our MLP, as we disclosed in our 10k for 2016, we created a new VLP segment to align with how we manage and allocate resources. Growth in our VLP segment is critical to Valero's strategy to optimize the supply chain. The third party acquisition of the Red River pipeline in January is an example of VLP executing this strategy, which is focused on assets that are key to Valero's operations or that will supply third party volumes without taking on commodity risk.

- Lastly, regarding cash returns to stockholders, we paid $629 million in cash through dividends and stock buybacks, so we believe we're in good shape to exceed our payout target for the year. This payout demonstrates the company's free cash flow generating capability even in a soft margin environment.
- So with that, John, I'll hand the call back to you.

John Locke

- Thank you Joe. For the first quarter, net income attributable to Valero stockholders was $305 million, or $0.68 per share, compared to $495 million, or $1.05 per share, in the first quarter of 2016. First quarter 2016 adjusted net income attributable to Valero stockholders was $283 million, or $0.60 per share. For reconciliations of actual to adjusted amounts, please refer to page three of the financial tables that accompany our release.
- Operating income for the refining segment in the first quarter of 2017 was $647 million, compared to $915 million for the first quarter of 2016, which has been revised retrospectively to reflect the new VLP segment. First quarter 2017 operating income was in line with first quarter 2016 adjusted operating income of $652 million.

- Refining throughput volumes averaged 2.8 million barrels per day, which was in line with the first quarter of 2016. Our refineries operated at 91 percent throughput capacity utilization in the first quarter of 2017, which reflects turnarounds that occurred at the Benicia, Texas City, St. Charles, and Meraux refineries.

- Refining cash operating expenses of $3.85 per barrel were $0.39 per barrel higher than the first quarter of 2016, mainly due to a higher level of maintenance activity and higher energy costs in the first quarter of 2017.

- The ethanol segment generated $22 million of operating income in the first quarter of 2017 compared to $39 million in the first quarter of 2016. Adjusted operating income for the first quarter of 2016 was $9 million. The increase from the 2016 adjusted amount was primarily due to higher ethanol prices and record production volumes.

- Operating income for the VLP segment in the first quarter of 2017 was $70 million compared to $43 million in the first quarter of 2016. The primary drivers for the increase in operating income are contributions from the McKee, Meraux, and Three Rivers terminals, and the Red River pipeline, which were acquired subsequent to the first quarter of last year. The Red River pipeline operations acquired in January have been integrated into VLP and are performing as expected.

- For the first quarter of 2017, general and administrative expenses excluding corporate depreciation were $190 million, and net interest expense was $121 million.

- Depreciation and amortization expense was $500 million, and the effective tax rate was 26 percent in the first quarter of 2017. The effective tax rate was lower than expected mainly due to a reduction in the statutory tax rate in Quebec and favorable settlements from several state income tax audits.

- With respect to our balance sheet at quarter-end, total debt was $8.5 billion, and cash and temporary cash investments were $4.5 billion, of which $66 million was held by VLP. Valero's debt-to-capitalization ratio, net of $2 billion in cash, was 24.1 percent. At the end of March, we had $5.4 billion of available liquidity excluding cash, of which $720 million was available for only VLP.

- We generated $988 million of cash from operating activities in the first quarter. Excluding a working capital benefit of $151 million, net cash generated was $837 million.

- With regard to investing activities, we made $641 million of growth and sustaining capital investments, of which $245 million was for turnarounds and catalyst.

- Moving to financing activities, we returned $629 million in cash to our stockholders in the first quarter, which included $315 million in dividend payments and $314 million for the purchase of 4.7 million shares of Valero common stock. As of March 31st, we had approximately $2.2 billion of share repurchase authorization remaining.

- Our guidance for 2017 capital expenditures of $2.7 billion remains unchanged. This amount, which includes turnarounds, catalyst, and joint venture investments, consists of approximately $1.6 billion for sustaining and $1.1 billion for growth.

- For modeling our second quarter operations, we expect throughput volumes to fall within the following ranges: U.S. Gulf Coast at 1.69 million to 1.74 million barrels per day; U.S. Mid-Continent at 440 thousand to 460 thousand barrels per day; U.S. West Coast at 285 thousand to 305 thousand barrels per day; and North Atlantic at 455 thousand to 475 thousand barrels per day.

- We expect refining cash operating expenses in the second quarter to be approximately $3.70 per barrel.

- Our ethanol segment is expected to produce a total of 3.8 million gallons per day in the second 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 second quarter to be around $170 million, and net interest expense should be about $115 million. Total depreciation and amortization expense should be approximately $500 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 the IR team if you have any additional questions. Thank you.