Valero Energy (VLO) Earnings Report: Q1 2015 Conference Call Transcript

The following Valero Energy conference call took place on April 28, 2015, 11:00 AM ET. This is a transcript of that earnings call:

Company Participants

- John Locke; Valero Energy Corp; IR
- Joe Gorder; Valero Energy Corporation; Chairman, President, CEO
- Mike Ciskowski; Valero Energy Corp; EVP, CFO
- Gary Simmons; Valero Energy Corp; SVP - Supply, International Operations & Systems Optimization
- Martin Parrish; Valero Energy Corp; VP - Alternative Fuels
- Lane Riggs; Valero Energy Corp; EVP - Refining Operations

Other Participants

- Evan Calio; Morgan Stanley; Analyst
- Neil Mehta; Goldman Sachs; Analyst
- Edward Westlake; Credit Suisse; Analyst
- Paul Cheng; Barclays; Analyst
- Chi Chow; Tudor Pickering Holt; Analyst
- Ryan Todd; Deutsche Bank; Analyst
- Jeff Dietert; Simmons and Company; Analyst
- Brad Heffern; RBC Capital Markets; Analyst
- Doug Leggate; Bank of America Merrill Lynch; Analyst
- Phil Gresh; JPMorgan; Analyst
- Sam Margolin; Cowen; Analyst
- Roger Read; Wells Fargo; Analyst
- Blake Fernandez; Howard Weil; Analyst

MANAGEMENT DISCUSSION SECTION

Operator:

Welcome to the Valero Energy Corporation reports 2015 first-quarter earnings results conference call. My name is Christine, and I will be your operator for today's call.

(Operator Instructions).

Please note that this conference is being recorded. I will now turn the call over to John Locke. You may begin.

John Locke (IR):

Thank you, Christine. Good morning, and welcome to Valero Energy Corporation's first-quarter 2015 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 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 free to contact our investor relations team after the call.

I'd 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 (Chairman, President, CEO):

Thanks, John, and good morning, everyone. As John will cover in more detail shortly, we reported record first-quarter earnings per share. With great performance in a favorable margin environment, we demonstrated Valero's earnings power in a heavy maintenance period. The one thing that I would like to reaffirm with you before we proceed is that our team remains focused on executing our strategies to improve our evaluation through operations excellence, optimizing our business through disciplined capital allocation, and unlocking asset value. With that, John, I will hand it back over to you.

John Locke (IR):

Thank you, Joe. What we would like to do now is highlight a few accomplishments this quarter that align with our key strategies and then we'll cover the quarter results. As noted in the release, our focus on operations excellence yielded solid results while we successfully managed a heavy turnaround season in the first quarter. For the remainder of 2015, we have a lighter schedule of planned maintenance, compared to the first quarter. We remain committed to deliver a payout ratio of earnings to our stockholders that exceeds 2014 ratio of 50%. So far, we are on track to meet those goals, with a 55% payout ratio on first-quarter 2015 earnings.

Regarding capital investments, we continue to optimize and improve our business while maintaining rigor in our capital budget. For 2015, we maintained our guidance for capital spending, including turnarounds and catalysts that are approximately $2.65 billion, which excludes $150 million for the St. Charles methanol project. The proposed St. Charles methanol project and Houston alkylation units remain under evaluation and are progressing through our gated project management process. We expect to make final investment decisions on these projects later in the second quarter. With respect to unlocking asset value and accelerating the growth of Valero Energy Partners LP, which is our sponsored master limited partnership, we are clearly delivering growth and have a backlog of assets to drop down. Given the closing of the $671 million drop-down of our Houston and St. Charles terminal services business in March, we're on track to complete our goal of $1 billion of drop-down transactions in 2015.

Now moving on to the quarterly results, we reported net income from continuing operations of $964 million, or $1.87 per share for the first quarter of 2015. Earnings per share was 21% higher than first-quarter 2014 earnings per share of $1.54. The refining segment reported first-quarter 2015 operating income of $1.6 billion versus $1.3 billion in the first quarter of 2014. We covered the key drivers of this increase in the release, but I'd like to highlight that while discounts were more narrow this quarter for most sweet and sour crude oils, relative to Brent crude oil by a dollar per barrel basis. On a percentage discount basis, these crudes were priced more favorably in 2015. For example, in the first quarter of 2015, Maya priced on the average at a 20% discount to Brent, versus the 17% discount in the first quarter of 2014. Our significant crude spike flexible allows us to adjust feedstocks and optimize margins based on a discount environment.

Refined throughput volume averaged 2.7 million barrels per day in the first quarter of 2015, which is an increase of 9,000 barrels per day, versus the first quarter of 2014. Volumes in utilization rates in both periods were impacted by heavy planned maintenance. Refining cash operating expenses were $3.95 per barrel in the first quarter of 2015, or $0.04 per barrel lower than the first quarter of 2014. That is our 12th consecutive quarter with cash operating expense below $4.00 per barrel. Our focus on safe and reliable operations, combined with advantage domestic energy costs, provides us a global manufacturing competitive advantage. The ethanol segment generated $12 million of operating income in the first quarter of 2015, versus $243 million in the first quarter of 2014. While ethanol margins compressed in the first quarter of 2015, they have rebounded some here in April. Longer-term, we believe ethanol remains a key component of the transportation fuel mix.

General and administrative expenses, excluding corporate depreciation, were $147 million in the first quarter of 2015, which is $13 million lower than the first quarter of 2014, primarily due to changes in legal reserves. Also in the first quarter of 2015, net interest expense was $101 million, and total depreciation and amortization expense was $441 million. The effective tax rate was 31.7%. With respect to our balance sheet at quarter end, total debt was $7.4 billion, and cash and temporary cash investments were $4.9 billion, of which $28 million was held by VLP. Valero's debt-to-capital ratio, net of $2 billion in cash, was 20.3%.

Valero had over $10 million of available liquidity, including cash. Cash flows in the first quarter included $698 million of capital spending, of which $240 million was for turnarounds and catalysts. We've also issued $1.45 billion of debt, which included $1.25 billion of bonds in March for general corporate purposes, including the refinancing of current maturities, and $200 million issued by VLP to partially fund their March acquisition. We returned $531 million in cash to our stockholders in the first quarter, which included $206 million in dividend payments and $325 million for the purchase of 5.4 million shares of Valero common stock. Year-to-date, we have purchased 7.1 million shares for $429 million.

Now for modeling our second-quarter operations, we expect throughput claims to fall within the following ranges. Gulf Coast at 1.55 million to 1.6 million barrels per day. Mid-Continent at 430,000 to 450,000 barrels per day. West Coast at 280,000 to 300,000 barrels per day. And North Atlantic at 460,000 to 480,000 barrels per day.

We expect refining cash operating expenses in the second quarter to be around $3.90 per barrel. Our ethanol segment is expected to produce a total of 3.7 million gallons per day in the second quarter. Operating expenses should average $0.38 per gallon, which includes $0.04 per gallon for non-cash costs, such as depreciation and amortization. We expect G&A expense, excluding corporate depreciation, for the second quarter to be around $175 million. And net interest expense should be about $105 million.

Total depreciation and amortization expense should be approximately $445 million and our effective tax rate is expected to be around 33%. Christine, we've concluded our opening remarks. In a moment, we will open the call to questions. During the segment, we ask that our callers limit each turn to only two questions. Callers may rejoin the queue with additional questions as time permits.

QUESTIONS & ANSWERS

Operator:

Thank you. (Operator Instructions). Evan Calio, Morgan Stanley.

Evan Calio (Analyst - Morgan Stanley):

Good morning guys. My first question relates to cash distributions and unlocking value. Cash returns averaging 7% yield year to date yet you also built one been dollars in cash in the quarter your now to the low-end of your leverage guidance of 20%-30%. I may mentioned a target payout ratio it how to determine an optimal cash position as it continues to build and determine when to increase the distributions from current rates?

Mike Ciskowski (EVP, CFO):

This is Mike. I do not have a precise number I can give you but what I can give you is that in our debt to cap ratio guidance, we expect that $2 billion from there we would like to keep some push and in our cash balance given the volatility of our business. And then we look at the future capital and working capital requirements and then the payout of greater than 50% that we have already committed to you guys. But I would like to point out that excluding the debt issue that we had in the first quarter, we actually have an increase in cash to about $300 million.

Evan Calio (Analyst - Morgan Stanley):

Right. That is upside scope I guess from a $5 billion cash position to distribution I guess would be my question.

Mike Ciskowski (EVP, CFO):

I would add further that we have committed to the greater than 50% payout. As we move through the year and if earnings and cash flow continued positive like they are, we will assess this and consider increasing that payout number.

Evan Calio (Analyst - Morgan Stanley):

That makes sense. And then my second question is more of the products demand side. Mobile crack spread's have been higher than many expected year to date. Global demand estimates continue to rise in response to low commodity prices. Is there any comments or what you are seeing through the system on demand trends and what you might expect for summer driving season. When it have seen in quite some time. Thanks.

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

This is Gary Simmons. I think definitely we've seen good crack spread environment I would say early in the year it was probably driven from we had some heavy turnaround payments refinery turnaround maintenance and that type of activity. Also I think the USW [indy] negotiations came into play are supportive of the crack spread. That is behind us now and I think really the market is being driven up by demand. We've seen some pretty encouraging numbers thus far. We expect that trend will continue and I think it's too early to tell what's the magnitude of the demand response will be to the flat pricing

Evan Calio (Analyst - Morgan Stanley):

Fair enough guys thank you.

Operator:

Neil Mehta, Goldman Sachs.

Neil Mehta (Analyst - Goldman Sachs):

Good morning. My first question is, thoughts on spreads. In particular Brent LLS which while Brent of WTI is healthy right now, LLS Brent looks a little bit tighter. Just any thoughts there and potential bottlenecks between Houston and St. James.

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

This is Gary again. I think you know the LLS Brent spread has been a little bit more narrow and what we would expect. I think ultimately the Gulf coast suite market has been priced set at a level that allows the East Coast refineries to be able to receive domestic light sweet crude by rail or ship. That tells you over time that LLS should be around two dollars discount to Brent as long as the standard transportation differentials in the Gulf hold. I think some of what you're seeing today is the Houston market is bottlenecks with logistics getting the St. James and so we're seeing Houston trade at a much wider discount the St. James than where it had been. And so that is going ahead and allowing the economics to hold but the right at breakeven and I would expect LLS to come off some.

Neil Mehta (Analyst - Goldman Sachs):

That is very helpful. And then on RINs just any thoughts as we get into the second quarter here on where RIN pricing are and where we should expect the impact on a go forward basis?

Martin Parrish (VP - Alternative Fuels):

This is Martin Parrish. We think the RIN is just where they are waiting on the EPA announcement in June. And just the uncertainty even though the EPA said they will set it at the levels are everyone just waiting to see. I think after June we'll see what happens then.

Neil Mehta (Analyst - Goldman Sachs):

All right very good. Thank you very much guys and talk soon.

Operator:

Edward Westlake, Credit Suisse

Edward Westlake (Analyst - Credit Suisse):

Good morning and I guess the first question still on the macro side. We are seeing a decent tanker fixtures from the Gulf to the salaries are still pumping mix going as well. How would you characterize at the moment the supply availability of waterborne mediums into the system?

Joe Gorder (Chairman, President, CEO):

It's been very good. Like you said we actually in the first quarter ran more South American crude than what we historically have run. The Saudis seem committed to the US market, so I don't that we will go back to levels of import that we saw three years ago but I definitely think we find some volumes US Gulf will be up from what we saw last year. We've seen a lot more heavy Canadian with the startup of [Flanagan] so overall the Gulf coast seems well supplied with all grades of crude.

Edward Westlake (Analyst - Credit Suisse):

Right okay. And then on the VLP obviously a great drop in March. Of $1 billion clearly very easy to achieve. Any view of going faster or you still think that $1 billion, which is still a healthy pace, is the right pace going forward?

Joe Gorder (Chairman, President, CEO):

This is Joe. We are very comfortable with the $1 billion pace this year. That would imply that we're going to execute another drop sometime in the second half of the are probably later in the second half of the year. But what our real focus is on the distribution increase and we're committed to growing into the 25% plus this year for the next couple of years. We are very comfortable with the pace we've got right now.

Edward Westlake (Analyst - Credit Suisse):

Okay thanks very much, Joe.

Operator:

Paul Cheng, Barclays.

Paul Cheng (Analyst - Barclays):

Joe, a couple of years ago the company was looking at California has always said is not really a call for the long haul and you're looking for if someone gives you an okay price that you would accept. Is there any change in the view from management about how you look at California from a long-term standpoint? And yet it is now part of your long-term olio, is there any initiate for you that your picking to improve the results relative to your peers that you seem to be lacking in their next

Joe Gorder (Chairman, President, CEO):

Paul we've said this before. On the West Coast we have very good assets and we have a very good management teams operating those assets. And frankly we view our portfolio on the West Coast is an option when the margins are strong on the West Coast. And certainly we're experiencing that today and we had a very good first-quarter. If you don't mind Paul what I will do is let Lane speak to our capital approach to the West Coast.

Lane Riggs (EVP - Refining Operations):

Hello Paul, it's Lane. We continue to be very disciplined in our capital. We look for small opportunities to improve capture but we have any major capital programs in the events that we spend much money we better opportunity than our Gulf coast and midcontinent. I would say though one of the things you'll see in terms of our market capture because we need to make so much gasoline you'll see our capture versus an index probably got quite a bit better because you know the first-quarter is really a story of on the West Coast of the West Coast gasoline fracking.

Paul Cheng (Analyst - Barclays):

The second question, Mike, going back to the cash position, is there a level you can share what is the comfort level of the cash that you want to hold?

Mike Ciskowski (EVP, CFO):

I don't really have guidance for you on a minimum cash balance. You can start with the $2 billion that we use in our debt to calculation. And then we would like to keep some cushion in that given the volatility of our business.

Paul Cheng (Analyst - Barclays):

I see, thank you.

Operator:

Chi Chow, Tudor Pickering Holt.

Chi Chow (Analyst - Tudor Pickering Holt):

Thanks good morning. I've couple of questions on North Atlantic market. You realized strong double-digit margins in that region for three quarters running now. You know pad one in European cracks been robust over this period. What you think the sustainability of the tighter product markets Atlantic basin region?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I think there's number of reasons for what we've seen in the first quarter and I think some of that is sustainable. Obviously we had strong turnaround maintenance in that area as well. Colder weather helped always helps with demand. But I think you've seen good demand response to lower flat price which is certainly constructive moving forward. I think other thing that's happened is the US dollar strengths versus the euro has updates with our operating costs at Pembroke as well. I think there's a lot of encouraging signs on the Atlantic basin

Joe Gorder (Chairman, President, CEO):

And then Chi this is Joe. The one thing I would add to Gary's points which are all correct is that the Pembroke asset is very good asset and we acquired when we bought that refinery was an integrated system. When you think about merchant refining in Europe, you shouldn't think about Pembroke in that regard. The distillate barrels we produce there are all moved inland and certainly a significant volume of the gasoline moves inland it's a little bit different set up then some might be experiencing.

Chi Chow (Analyst - Tudor Pickering Holt):

Are you concerned about distillate crack spread weakness going forward with all the global capacity coming online in the last year or so?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I would say we're not that concerned about distillate cracks in our system. I think there's a couple things. The U.S. market has been so strong. We still see good export demand however we been somewhat priced out of the market because our market has been so strong. I think we think moving forward we'll see a combination of better demand domestically and we will see that our export lines will pick up again as the US market falls off a little bit.

Chi Chow (Analyst - Tudor Pickering Holt):

What were your export volumes for the quarter on gasoline diesel?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

Gasoline was down a little bit to 94,000 barrels per day. The reason for that was really just because of the strength in the US market. Again that's an optimization for us so we would say that when we optimize that it's more demand rather than supply push. And export market really is more strong enough on gasoline to pull the barrels away from the Gulf. Our distillate volumes were fairly flat about 205,000 barrels a day ULSD, if you look at ULSD plus kerosene we were up over 25,000 barrels per day. So fairly consistent there. The change we saw was that for a lot of the first-quarter the [ard] to Europe wasn't open so we're are easily 60/40 between America and Europe up 70% of our volume actually went to Latin America and we didn't see that flow to Europe that we've traditionally seen.

Chi Chow (Analyst - Tudor Pickering Holt):

Okay great one more question on the north Atlantic. Could you talk about how to line nine [b] reversible is going to impact recruit sourcing options of [that port]?

Joe Gorder (Chairman, President, CEO):

I'll give you a little update on that. We're still waiting for revelatory approval online nine for the national energy Board in Canada. We don't know a timeline on that. We feel like there's a good chance they could approve that by mid-May. With a mid-May approval, that would mean we really won't see any impact from line 9 in the second quarter but we're optimistic we'll start to receive oil in the third quarter given a lot more flex ability in Quebec to be able to have access to those Western Canadian and Bakken grades and not just rely on rail and US Gulf Coast source barrels.

Chi Chow (Analyst - Tudor Pickering Holt):

Okay great thanks I appreciate it.

Operator:

Ryan Todd, Deutsche Bank.

Ryan Todd (Analyst - Deutsche Bank):

Thanks. Good morning gentlemen. If I could follow up first with a question on VLT. I know earlier we talked about potential for an evaluation of the wholesaler fields distribution, EBITDA's potential drop to VLT. Could you talk a little bit about whether that is still under evaluation and any rough guide us to what that figure but look like?

Mike Ciskowski (EVP, CFO):

Yes Ryan this is Mike. We are still evaluating that in the appropriate structure that we would consider to drop in the MLP. I do not have a number that I can give to you on this call.

Chi Chow (Analyst - Tudor Pickering Holt):

Okay. Great. I appreciate it. Maybe just a general -- we see the margins on the screen which was supportive but can you give us an update on what you seen a month into the second quarter in terms of general operating environment?

Joe Gorder (Chairman, President, CEO):

Yes. The cracks continues to be strong. We continued to see good discounts on the crude. The big change probably is been in the crude markets some of the discounts have come in, so we're running a lot more light sweet crude in our system today, than what we did in the first quarter. But again I think we're seeing good demand both and export market and domestic demand. And so we feel very encouraged about profitability moving forward.

Chi Chow (Analyst - Tudor Pickering Holt):

Great thanks I appreciate it.

Operator:

Jeff Dietert, Simmons and Company

Jeff Dietert (Analyst - Simmons and Company):

Good morning. I had a strategic question. I think historically Valero has been more of our refining to replay relative to some of the pure strategies that have been more integrated. You guys have sold off new star interest in core store and I was hoping for an update on how Valero's strategy has evolving going forward. What you think about integration through the value chain, do you expect a materially larger midstream business?

Joe Gorder (Chairman, President, CEO):

That is a good question. Very clearly we are a fuels manufacturing company. And certainly that involves refining it also involves our renewable fuels business. That is such a significant part of the portfolio today to see any significant shift from that is really not in the cards. To answer your question on the midstream business, I do think that we're going to see our midstream business expand significantly over the next several years. And as we have said, our strategy in midstream is really to develop projects and acquire assets that are supportive of Valero's core businesses. I think if you look at the investment that we've made to date it would certainly support that. That being said the refining portfolio is large enough and the renewables portfolio is large enough that provides Pontiff opportunity for growth within that midstream business. I don't think you should expect us to be looking upstream from where we are today at any material way or significantly downstream from where we are today. Although opportunities present themselves and you look at it but certainly that is not part of our plan today.

Jeff Dietert (Analyst - Simmons and Company):

And thank you. Secondly looking through your refinery throughput guidance for the second quarter, it looked relatively conservative. My question is are the LP suggesting you should maximum and under what conditions would you run more aggressively or perhaps less aggressively?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I think and terms of throughput probably the biggest thing that can change is we see a pretty good rate lever on some of our plans depending on if we're maximizing heavy sour versus light sweet. Especially in Port Arthur Jeff, it can change our throughput significantly. We start maximizing light sweet over heavy sour. I would say that was the only thing I could see.

Jeff Dietert (Analyst - Simmons and Company):

Thanks for your comments.

Operator:

Brad Heffern, RBC Capital Markets

Brad Heffern (Analyst - RBC Capital Markets):

Good morning everyone. Just following up on a couple previous answers looking for some more color. I think in the first quarter you talked about the sheer number of waterborne crudes that were trying to find their way into the Valero system. Is that you're running less waterborne now and more domestic suggestive that maybe the global crude environment isn't is oversupplied as it was a few months ago?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I think there has been a couple of events that are driving the crude differentials. First the medium sour market in the Gulf due to the market structure a lot of people were pulling their barrels off the market trying to hold them and collect the roll, so it kind of tightened up the medium sours. Now that storage is getting full. You also have some turnaround maintenance going on to the Deepwater platforms in the Gulf. That is also tightening the market a little bit. And in the heavy sour side on the [Mia] you have the fire on the platform in Mexico which has also disrupted production there. So my view is that these crudes have to commit with light sweet and we will see the differentials come back as we move forward in the second quarter.

Brad Heffern (Analyst - RBC Capital Markets):

That is great color. And maybe for Joe, a lot of the MPs have seen pretty confident of likes that the crude export ban is going to be lifted in the near-term maybe in 2015. Do have any updated thoughts or anything even hearing about that?

Joe Gorder (Chairman, President, CEO):

I think we're probably hearing the same thing that you are hearing. And we know that there is activity in the House and Senate to bring the issue forward. But certainly a ministration doesn't seem at all receptive to this. And just to be clear on our position, we believe in free and open markets. As we talked about many times, there's currently legislation and regulations in place that hinders the petroleum markets from being free and open and these would include things like the crude export ban copy RFS, the Jones act and others. We believe that looking at a specific issue relative to the overall issue is just another way to deal with this topic.

And you need to deal with all of the issues. The one thing about Valero is that we've continued to invest and we're running significant quantities of domestic or today and we continue to invest to enable us to run more of this crude. We are doing what we can to process it as our many other refiners. And really the last point on this is when you look at the general need for crude exports, the US remains the net importer of crude oil with about 7 million barrels per day coming in. We certainly export much lower volumes than that. The question becomes do you really need the exports? I think that is the question on everybody's mind.

Brad Heffern (Analyst - RBC Capital Markets):

Okay great. That's it for me. Thanks.

Operator:

Doug Leggate, Bank of America Merrill Lynch.

Doug Leggate (Analyst - Bank of America Merrill Lynch):

Thanks good morning everyone. If I could follow up on the last question on exports, Joe, from what we were seeing it looks like light sweet imports from the Middle East in particular looking at Kuwait in particular is one example -- they seem to have been increasing. I'm curious as to what is your strategy around accessing light sweet or just generally crudes outside the US and how do think that impacts the crude export debate because of the that's one of the key issues is that as opposed to the issue in itself.

Joe Gorder (Chairman, President, CEO):

Sure Doug. I'll let Gary speak to the imports.

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

Doug I would tell you that primarily what we see from Kuwait is really not light sweet is more medium sour barrels. And I would tell you that we've have had many discussions with them and they seem interested on maintaining or actually growing market share in the US on that grade of crude. On the light sweet, a lot of what we see happen with the volatility in the Brent TI are moving in and out. When the arb comes in very narrow then we start to see incentives to import light sweet. And the first-quarter we deftly saw that and as I discussed in past the first place we generally see it is in Quebec and there were certainly times in the first quarter were the Brent TI arb got narrow enough that it incentivized to step back in and buy Brent related West African type crudes.

Doug Leggate (Analyst - Bank of America Merrill Lynch):

Okay I appreciate the answer. I'm always watching that one closely. My follow-up Joe is on the return of cash to shareholders. It's obviously a share price I guess all the refiners have done well from a lot of the strength in the first quarter. I think you guys said yourself in your prepared marks the businesses obviously volatile. When you think about the last time your predecessor had a very substantial share buyback program and where the share price is now in the fact that you are again embarking on very substantial share buyback program, I do think about balancing the timing and the balance between dividends another methods of returning cash as opposed to our buying back stock at current levels? And I will leave it there. Thanks

Joe Gorder (Chairman, President, CEO):

Doug I will speak to briefly and then see if Mike has anything to add. The timing of the market is something that it's almost impossible to do. I think the particular transaction referring to might've been the accelerate share repurchase the we executed some years ago. We don't have plans to do that. I don't want to get into being specific about our strategies around share repurchases other than that we have committed to this greater than 50% payout ratio which we've said would be a blend of repurchases and dividend. With a significant increase in the dividend at the end of January. And we continue to look at cash and how we're going to employee it's with a capital budget that is very manageable. In the current context. I think if you said what are your plans? I think our plans are to continue to buy back shares certainly to meet the greatest 80% target. Mike is there anything you would add?

Mike Ciskowski (EVP, CFO):

I think that was well said.

Operator:

Phil Gresh, JPMorgan.

Phil Gresh (Analyst - JPMorgan):

Hi good morning. First question on the midstream and a potential. I appreciate the color you give an already but just a follow-up. Would you rather have more EBITDA dropped at this point before you consider midstream M&A at VLP or are you comfortable with the amount of EBITDA there already and to the extent that you would consider midstream M&A, would you likely want to do it at the Valero level given the amount of cash you have available right now?

Mike Ciskowski (EVP, CFO):

Phil this is Mike. I think at this point in the VLP stage that probably would prefer to do the drops and get a little bit more sizable before they start taking on third party acquisitions. As you know the drops, with minimum volume, means that you may not always get in a third party deal. Depending on the deal. So given their size I would say the drops are the more likely path that they will go.

Phil Gresh (Analyst - JPMorgan):

Got it, okay. And just one final question on the export ban. I guess the question is really if you think about the band being lifted, if it were to happen, would this materially change how you manage our business whether it's growth projects are refining or logistics or potential M&A aspirations? Just generally how do you think about your managing our business today versus in that kind of a world? And think about current differentials?

Joe Gorder (Chairman, President, CEO):

I will fly over this and then we will let Gary speak to it if he would like to also. Our strategy is to optimize our operations. And that is a broad statement. I know that goes to our crude and feedstocks, it goes to our disposition of our products. It goes to our capital investment. And so I think what you would see certainly there is nothing that we are doing today that I would say we need to change in a crude export environment. But we have to see what the market does and how the market would respond to that. I guess you are pushing additional crude barrels into a market that seems to be well supplied today. And so the question in our might is how is the market going to react to that and honestly I don't think we're smarter tell you what that would be. Gary do have anything?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I agree. Overall even if the export ban was lifted, we would continue to have a location advantage running the domestic crude. We continue to have significant operating cost advantage with a cheap natural gas. And then we're very happy with our portfolio of refining assets that are very complex and very efficient refineries.

Phil Gresh (Analyst - JPMorgan):

We have a material change on your view of crude differentials?

Joe Gorder (Chairman, President, CEO):

No I don't think so. I think overall the crude has to continue to compete for space in the refineries and so we're going to be the beneficiary of that.

Phil Gresh (Analyst - JPMorgan):

Okay great, thanks a lot.

Operator:

Sam Margolin, Cowen.

Sam Margolin (Analyst - Cowen):

Good morning. I want to ask about the notes offering from earlier within the context of the gated process you guys have talked about a lot. How was the pricing relative to your expectations? The change anything as far as return hurdles or maybe opening up some more capital intensive optimization plans or even on the M&A side? Or was it pretty much in line with what you are expecting?

Mike Ciskowski (EVP, CFO):

The interest rates were well and pretty much where we expected that offering to come in at. The funds will be used for general corporate purposes including the refinancing of our current maturities. I do not think that the issuance of that debt will increase any gated capital projects or anything like that. It was an opportunity to issue debt at a low rate.

Sam Margolin (Analyst - Cowen):

Okay. Thanks a lot. I don't think I heard you guys mentioned methanol in the prepared remarks. I'm assuming this question isn't going to get very far but I'll ask anyway. Is there anything incremental there to update us with? Or is still just in the evaluative stages and we'll wait on the final decision?

Lane Riggs (EVP - Refining Operations):

This Is Lane. I will just give you a bit of an update. It's where it's been. We're anticipate our funding decision here late in the second quarter. I would just add that any real, if this project goes forward in our strategy we obviously more than likely have a partner. I would add in terms of maybe what some of our public comments were, but we're still on track review the project here late in the second quarter.

Sam Margolin (Analyst - Cowen):

All right perfect. Thanks.

Operator:

Roger Read, Wells Fargo

Roger Read (Analyst - Wells Fargo):

Good morning. I wanted to follow up I guess Jeff Dietert's question about potential higher throughput and then what signals maybe we need to look for here either in terms of the Brent LLS relationship or are there other last mile pipeline issues in the Gulf coast? To think about you hitting a higher throughput number in the second quarter? Potentially getting a higher number I'll say?

Joe Gorder (Chairman, President, CEO):

I don't really know unless Lane comments. The only thing I can think of is, we're definitely seeing higher ones of light sweet crude which can have a rate leverage in terms of heavy sour refiners but I don't have anything else that would signal significant way different throughput.

Lane Riggs (EVP - Refining Operations):

I concur. Right now our economic signals our maximum throughput and Gary mentioned earlier there's obviously a rate thing that occurred depending on whether we're running late medium or heavy sour crude that obviously has an impact on our overall throughputs.

Roger Read (Analyst - Wells Fargo):

Okay thanks. And then back to the OpEx, the initial comments mentioning under $4.00 for several quarters in a row. And then the Fx strength that helped out Pembroke. Could you walk us through -- is there anything operationally challenged and succeeded on or are we looking at it is cheap natural gas and it's an FX item flowing through that is help to lower OpEx? I know throughput has been high also helps on a per barrel basis but if there's anything else you could offer that would be great.

Lane Riggs (EVP - Refining Operations):

This is Lane. We're always vigilant on operating costs. It is our culture we work every day every month every our to make sure that we are vigilant in maintaining our fixed and structural operating costs. The benefit from lower natural gas prices in the first quarter versus the fourth and last year. Throughputs were a little bit lower and so partially offset by that but will absolutely maintain our focus on having low operating costs.

Roger Read (Analyst - Wells Fargo):

But nothing specific we should think about, just a general pressure on the system?

Lane Riggs (EVP - Refining Operations):

No.

Roger Read (Analyst - Wells Fargo):

Thank you.

Operator:

Blake Fernandez, Howard Weil.

Blake Fernandez (Analyst - Howard Weil):

Hi guys, good morning. Two questions for you. One you mentioned in the press release the benefit of secondary product pricing. And I assume that is some spillover from the collapse in crude prices but now that we are starting to see a reversal in the crude markets and moving higher, are you starting to see a bit of a reversal in that secondary product pricing here into 2Q?

Joe Gorder (Chairman, President, CEO):

I would differently say that when you get out into the products other than gasoline and distillates, sulfur, [padco LPGs], a lower flat price environment tends to have these products trade closer to crude value, and it helps us on a frac realization. And as crude moves up then the reverse would also be true.

Blake Fernandez (Analyst - Howard Weil):

Okay. Gary secondly, just to follow-on from your previous export commentary should we've seen away from Europe, can you talk a little bit about the arbitrage that's needed there, in other words to drive the economics to incentivize a transport over to Europe. Is it basically like a dollar or two a barrel that's needed? And maybe as a follow-on to that, do have any sense - I know you mentioned indigenous demand growth year -- but you have any sense that maybe aside from European utilization rates moving up are any of the new global facilities beginning to penetrate the market? Give any color there. I'd appreciate it. Thanks.

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

I'll start with that. We still feel like our traditional export markets are there for us as long as its economic for us to supply those markets. And we have seen it move back to where the to arb to Europe is open. It's basically just looking at the differences in the two markets freight and we also take into effect the RIN. The higher RIN prices that we're seeing today help to incentivize the exports of distillate to Europe. Freight generally a little over two dollars to get a barrel to Europe and then the RINs in the $0.71 range in that gives you the differential that is needed to support exports.

Blake Fernandez (Analyst - Howard Weil):

Okay thanks.

Operator:

Paul Cheng, Barclays

Paul Cheng (Analyst - Barclays):

Hi guys. Two quick follow-ups. One Joe, could you give us -- maybe this is for Lane. The [McKey Crew] expansion, are we done yet or what is the schedule now?

Lane Riggs (EVP - Refining Operations):

We will finish that -- this Is Lane, Paul, we will finish it up in the third quarter of this year.

Paul Cheng (Analyst - Barclays):

Maybe this is for Gary. Are you guys currently given the current events are you exporting crude oil from the Gulf coast to Quebec? And also after the line 9 reversal complete do you still need to export from the Gulf coast to get sufficient Western Canadian crude into Quebec?

Gary Simmons (SVP - Supply, International Operations & Systems Optimization):

Yes Paul, we are exporting from the Gulf in Quebec in the first quarter a little over 70% of our diet was crude sourced from Canada and the US Gulf. And post line nine we would still anticipate that we would see some flow of oil from the US Gulf coast to Canada over the line.

Paul Cheng (Analyst - Barclays):

Can ask a final question?

Joe Gorder (Chairman, President, CEO):

Just for you, Paul.

Paul Cheng (Analyst - Barclays):

Thank you. In the last two years when we looked at from the first to the second quarter, your margin capture rate seems like it was on average dropped by about 10%. In the first quarter this year that you have far more heavy downtime especially in the Gulf coast and in the second quarter your full-year will be much higher. Should we still assume that your margin capture rate would be the pattern will be similar to last two years the drop of roughly about 10% from the first quarter? Or that the we should view it somewhat differently?

Joe Gorder (Chairman, President, CEO):

Yes Paul generally what you see happening is the transition from the first second quarter you go through [RVP] transition on the gasoline. And in the decrease intake lending which drives down our crack containment. You're correct that as we have later turnaround means activities in the Gulf is should offset some of that. Where we come out I don't know that I've looked at it.

Paul Cheng (Analyst - Barclays):

Okay thank you.

Operator:

We have no further questions. I will now turn the call back over to John Locke.

John Locke (IR):

Okay great. Thanks Christine we appreciate those who called in today and everyone listening. If you have additional questions please contact me or Karen in the IR department. Thank you.

Operator:

Thank you. And thank you ladies and gentlemen this concludes today's conference. Thank you for participating. Your may now disconnect.