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Valero Energy's (VLO) CEO Joe Gorder on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release *10-Q*

EPS of $1.48 beats by $0.13 | Revenue of $27.25B (-11.67% Y/Y) beats by $1.32B

Earning Call Audio

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Valero Energy Corporation (NYSE:VLO) Q3 2019 Earnings Conference Call October 24, 2019 10:00 AM ET

Company Participants

Homer Bhullar – Vice President, Investor Relations

Joe Gorder – Chairman, President and Chief Executive Officer

Gary Simmons – Senior Vice President of Supply, International Operations & Systems Optimization

Martin Parrish – Senior Vice President of Alternative Fuels

Jason Fraser – Executive Vice President and General Counsel

Lane Riggs – Executive Vice President and Chief Operating Officer

Donna Titzman – Executive Vice President and Chief Financial Officer

Conference Call Participants

Neil Mehta – Goldman Sachs

Roger Read – Wells Fargo

Manav Gupta – Credit Suisse

Phil Gresh – JP Morgan

Prashant Rao – Citigroup

Paul Cheng – Scotia Howard Weil

Doug Leggate – Bank of America

Sam Margolin – Wolfe Research

Brad Heffern – RBC

Jason Gabelman – Cowen

Patrick Flam – Simmons Energy

Matthew Blair – Tudor Pickering Holt

Operator

Ladies and gentlemen, thank you for standing by, and welcome to Valero Energy Corporation's Third Quarter 2019 Earnings Conference Call. At this time, all participants' lines are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session. [Operator Instructions] Please be advised that today's conference maybe recorded. [Operator Instructions]

I'd now like to hand the conference over to your speaker today, Mr. Homer Bhullar, Vice President, Investor Relations. Please go ahead, sir.

Homer Bhullar

Good morning, everyone, and welcome to Valero Energy Corporation's third quarter 2019 earnings conference call. With me today are Joe Gorder, our Chairman, President and Chief Executive Officer; Donna Titzman, our Executive Vice President and CFO; Lane Riggs, our Executive Vice President and COO; Jason Fraser, our Executive Vice President and General Counsel; and several other members of Valero's senior management team.

If you've 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 now 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'll turn the call over to Joe for opening remarks.

Joe Gorder

Thanks, Homer, and good morning, everyone. We're pleased to report that we delivered solid financial results despite challenging market conditions again this quarter. Although gasoline cracks held steady and diesel cracks improved from the previous quarter. Heavy and medium sour crude all discounts the Brent crude oil remain narrow. Its supply was constrained by geopolitical events.

Also the start up of new pipelines from the Permian Basin to the Gulf Coast tighten the WTI Midland to Cushing crude oil differential. Despite these headwinds, we generated $1.4 billion in operating cash flow. Once again, demonstrating the flexibility and strength of our assets to deliver steady earnings and free cash flow.

During the quarter, we began to enjoy the benefits of our investments in the new Houston alkylation unit that was commissioned in June and from the recently completed Central Texas pipelines and terminals project. The alkylation unit upgrades lower value natural gas liquids and refinery olefins to a premium high octane outlet product. And the Central Texas pipelines and terminals reduce secondary costs and extends our supply chain from the Gulf Coast to a growing inland market.

Other strategic growth projects and execution remain on target. The Pasadena terminal, St. Charles alkylation unit, and Pembroke cogeneration unit are expected to be completed next year, with the Diamond Green Diesel expansion expected to be completed in 2021 and the Port Arthur Coker in 2022.

In September, our Diamond Green Diesel joint venture initiated an advanced engineering and development cost review for a new renewable diesel plant at our Port Arthur Texas facility. If the projects approved, construction could begin in 2021 with operations expected to commence in 2024. This would result in Diamond Green Diesel production capacity increasing to over 1.1 billion gallons annually.

The guiding framework underpinning our capital allocation strategy remains unchanged. We continue to expect our annual CapEx for both 2019 and 2020 to be approximately $2.5 billion with $1 billion allocated for projects with high returns that are focused on market expansion and margin improvement.

During the third quarter, we returned $679 million to stockholders, which represents a payout ratio of 61% of adjusted net cash provided by operating activities. We continue to target an annual payout ratio of 40% to 50%. Looking forward, we're encouraged. Fourth quarter market conditions are favorable. Distillate and gasoline margins are significantly higher than last quarter and this time last year supported by strong fundamentals, good demand and wider medium and heavy sour crude all discounts.

In closing, our team's simple strategy of striving for operational excellence, investing to drive earnings growth with lower volatility and maintaining capital discipline with an uncompromising focus on shareholder returns has proven to be successful and positions us well for any market environment.

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

Homer Bhullar

Thanks, Joe. For the third quarter of 2019, net income attributable to Valero stockholders was $609 million or $1.48 per share, compared to $856 million or $2.1 per share in the third quarter of 2018.

Operating income for the Refining segment in the third quarter of 2019 was $1.1 billion compared to $1.4 billion for the third quarter of 2018. The decrease from the third quarter of 2018 is mainly attributed to narrower crude oil discounts to Brent crude oil. Refining throughput volumes averaged 2.95 million barrels per day, which was 146,000 barrels per day lower than the third quarter of 2018. Throughput capacity utilization was 94% in the third quarter of 2019. Refining cash operating expenses of $4.05 per barrel, where $0.33 per barrel higher than the third quarter of 2018, primarily due to higher maintenance activity and lower throughput in the third quarter of 2019.

The Ethanol segment generated a $43 million operating loss in the third quarter of 2019 compared to $21 million in operating income in the third quarter of 2018. The decrease from the third quarter of 2018 was primarily due to lower margins resulting from higher corn prices. Ethanol production volumes averaged 4 million gallons per day in the third quarter of 2019. Operating income for the Renewable Diesel segment was $65 million compared to $5 million operating loss in the third quarter of 2018.

Renewable diesel sales volumes averaged 638,000 gallons per day in the third quarter of 2019, an increase of 387,000 gallons per day versus the third quarter of 2018. The third quarter 2018 operating results and sales volumes were impacted by the plan downtime of the Diamond Green Diesel plant as part of completing an expansion project. For the third quarter of 2019, general and administrative expenses were $217 million and net interest expense was $111 million.

Depreciation and amortization expense was $567 million and income tax expense was $165 million in the third quarter of 2019. The effective tax rate was 21%. With respect to our balance sheet at quarter end, total debt was $9.6 billion and cash and cash equivalents were $2.1 billion. Valero's debt-to-capitalization ratio net of $2 billion in cash was 26%. At the end of September, we had $5.4 billion of available liquidity, excluding cash.

With regard to investing activities, we made $525 million of capital investments in the third quarter of 2019, of which approximately $305 million was for sustaining the business, including costs for turnarounds, catalysts, and regulatory compliance. Net cash provided by operating activities was $1.4 billion in the third quarter. Excluding the impact from the change in working capital during the quarter, adjusted net cash provided by operating activities was $1.1 billion.

Moving to financing activities, we returned $679 million to our stockholders in the third quarter. $372 million was paid as dividends with the balance used to purchase 3.9 million shares of Valero common stock. The total payout ratio was 61% of adjusted net cash provided by operating activities. This brings our year-to-date return to stockholders to $1.7 billion and the total payout ratio to 54% of adjusted net cash provided by operating activities.

As of September 30, we had approximately $1.7 billion of share repurchase authorization remaining. We continue to expect annual capital investments for both 2019 and 2020 to be approximately $2.5 billion with approximately 60% allocated to sustaining the business and approximately 40% to growth. The $2.5 billion includes expenditures for turnarounds, catalyst and joint venture investments.

For modeling our fourth quarter operations, we expect refining throughput volumes to fall within the following ranges: U.S. Gulf Coast at 1.71 million to 1.76 million barrels per day; U.S. Mid-Continent at 410,000 to 430,000 barrels per day; U.S. West Coast at 260,000 to 280,000 barrels per day; and North Atlantic at 475,000 to 495,000 barrels per day. We expect refining cash operating expenses in the fourth quarter to be approximately $3.95 per barrel.

Our Ethanol segment is expected to produce a total of 4.3 million gallons per day in the fourth quarter. Operating expenses should average $0.39 per gallon, which includes $0.06 per gallon for non-cash costs, such as depreciation and amortization. With respect to the

Renewable Diesel segment, we still expect sales volumes to be 750,000 gallons per day in 2019. Operating expenses in 2019 should be $0.45 per gallon, which includes $0.16 per gallon for non-cash costs, such as depreciation and amortization.

For 2019, we expect G&A expenses excluding corporate depreciation to be approximately $840 million. The annual effective tax rate is estimated at 22%. For the fourth quarter, net interest expense should be about $113 million and total depreciation and amortization expense should be approximately $565 million. Lastly, we still expect the RINs expense for the year to remain between $300 million and $400 million.

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. If you have more than two questions, please rejoin the queue as time permits. This helps us ensure other callers have time to ask their questions.

Question-and-Answer Session

Operator

[Operator Instructions] Your first question comes from the line of Neil Mehta with Goldman Sachs. Your line is now open.

Neil Mehta

Good morning. Thanks for taking the question. Let me start off with the obligatory IMO 2020 question. The cracks obviously are very strong. We're seeing spreads widening out. How much of the strength you see on the screen? Do you think it's a function of just turnaround activity versus something that's the beginning of a more sustainable IMO impact and maybe it's a 30,000 foot question here is, how do you think IMO plays out versus sustainability and the depth of impact, as we think about your model over the next couple of years?

Joe Gorder

Good morning, Neil. Okay. Gary, you want to...

Gary Simmons

Yes, Neil, I think, the products cracks, it's pretty difficult to be able to determine how much of the strength in the crack is IMO-related and how much is just fundamentals and supply. But we're certainly seeing a lot of indications in the market of IMO starting to impact it. I mean the things I would point to, the diesel curve is just continued to shift higher, the closer we get to the January 2020 date.

On the gasoline market, we're seeing indications as well. Our view was that you would see some of these low-sulfur feedstock, the cat crackers being pulled out of the cats and put into the low-sulfur bunker market. If you look today, low-sulfur VGO is $5 over gasoline in the Gulf, which is to the point where you'll start to see people pull that out of cat crackers and put it into low-sulfur bunkers, which should impact gasoline yield moving forward.

And then the big thing that I think is very visible is on the feedstock side of the business. High sulfur fuel, it traded as high as 95% of Brent earlier this year. This morning trading at 61% of Brent. The forward curve on high sulfur fuel oil was backward indicating it's going to get weaker as we go forward.

And as you would expect, as high sulfur fuel oil has traded weaker we're starting to see that in the crude quality discounts. So through most of the year, we've had heavy sour trading inside of a 10% discount to Brent. It's almost 20% discount to Brent today, Maya and WCS. I think Maya trading at 11.50% discount to Brent today. And we're seeing medium sours that get weaker as well. So I think on the feedstock side of the business, it's pretty clear, we're getting an impact not as clear, but I think we are also seeing it on the product side.

Neil Mehta

Thank you. And then the follow-up question is around renewable diesel and maybe Joe, can you just talk about how you see this part of the business fitting into your long-term strategy? And then how you think about the gating factors for adding that capacity that you talked about in the call and then anything around blender's tax credit. So a lot of pieces to that, but just if you can fill in the gaps as it relates to renewable diesel, because we think it's – it can be an important part of the story going forward.

Joe Gorder

Yes, I mean you took a book out of Paul Cheng's – page out of Paul Cheng's book here. You got first three questions there. I'll speak about part of it, I'll let Martin speak about part of it and Jason might want to cover kind of the probabilities for the blender's tax credit. But I mean strategically, we are a company that really makes motor fuels, and we're a company that takes their environmental responsibility and sustainability very seriously.

And so when we look at the opportunities to produce products where there is going to be growth in the market and they're going to have sustainably high margins, we look to renewable diesel. We just think it's a really good business. We've got a really good partner in Darling. And it's something that we know how to do. We know how to run these processes very well. And so it fits right down the middle of our fairway and so we feel very good about not only the returns, but overall EBITDA contributions that we're going to get from this product for a very long time to come. So Martin, you want to cover a piece of it.

Martin Parrish

Sure, Joe, thanks. Yes, we're bullish on renewable diesel. We expect demand growth to be strong. You've got the Renewable Energy Directive II in Europe now that's been extended to 2030. The California LCFS has been extended out the 2030 and calling for 20% greenhouse gas reduction in 2030. And then the recent elections in Canada would tell us, we're probably going to see a national standard in Canada, too. And then you've got New York State. So we think the future demand for renewable diesel just looks very strong.

Joe Gorder

You want to talk about blender's tax credit?

Jason Fraser

Yes, this is Jason. I'll give you an update on the blenders' tax credit. As you all know, it expired at the end of 2017. Both Chambers of Congress have proposed legislation that would extend it. I think the Senate has got it going out for two years and this is back retroactive to 2018, and out for three negotiations on the BTC and other tax extenders are now taking place within the context of the appropriations process.

We're optimistic it will get done, because the BTC remains one of Senate Finance Chairman, Grassley's top priorities, and there's really not a lot of opposition to it. However, this impeachment process is certainly interfering with the bipartisan cooperation that you need to get the package agreed to. So that's what's created a little, a little more uncertainty than there was before.

Joe Gorder

Hey Neil, one other point I think that we'd like to make on this, Martin can speak to, why isn't – why aren't we doing like 200,000 barrels a day of this, so.

Martin Parrish

I think the constraints to look at is in the late feedstock market and we're confident we can source it and we're not worried about that any time soon. But that's the ultimate constraint on this as the feedstock. The feedstock supply is tied to global GDP per person, these ways feedstocks that's increasing. So we feel good about being able to source the feedstock. And our partnership with Darling, they are a global leader in this. They process 10% of the world's meat byproducts, so we feel we're in a good place on securing the feedstock.

Neil Mehta

Appreciate all the perspective.

Operator

Our next question comes from Roger Read with Wells Fargo. Your line is now open.

Roger Read

Yes, thank you. Good morning.

Joe Gorder

Good morning, Roger.

Roger Read

Yes, couple of things to dig into a little, maybe more on the macro front. Just in terms of product demand, I recognize you can't give us absolutely clarity on what's driving what, but we've got good cracks on even the light crude. So in spite of IMO things look better, I was just curious maybe going back to Neil's question there on how much of this might be turnarounds versus, what we're actually seeing in terms of the solid backdrop on the demand front?

Gary Simmons

Yes, Roger. So I think to me, if you look at product inventories and you roll back to early August, total light products inventory was 16 million barrels above where we were in 2018 at the same time period. Now over the last two months, we've had significant product growth such that – the last set of stats, we were 19 million barrels below where we were in 2018. So in the period of just a couple of months, you've had a year-over-year change in total light product inventories, at 35 million barrels, which is a pretty staggering figure.

And so if you look at that break it down, we see good demand, vehicle miles traveled look good, the tonnage index looks good. But then there is certainly some things that are supply driven as well. Shut down of PES, some planned and unplanned refinery outages have driven that as well and helps poor product fundamentals. But moving forward you look and gasoline sitting just a little above the five-year average range, diesels at the lower end of the five-year average range on apparent days of supply, both gasoline and diesel below the five-year average range. So the fundamentals look very good for both gasoline and distillate moving forward.

Roger Read

Okay, great. And then just couple of follow-up on that. We've obviously seen this issue in the tanker market, part of that is clearly related to IMO with ships going into the dry docks for retrofitting on the scrubbers. But I was curious as we look at the risk of some of these product tankers on the clean side moving into the crude markets chasing rates, do you think would any legit risk of tightness in product tanking markets that could impact your export story as we go forward?

Gary Simmons

Yes, Roger, I think for us, most of our exports are short haul market. So we're primarily going to Mexico and South America and freight rates by get actually gives us a competitive advantage for other people trying to get to those markets. So I don't really know that it's much of a risk to us.

Roger Read

All right, great. Thank you.

Operator

Our next question comes from the line of Manav Gupta with Credit Suisse. Your line is now open.

Manav Gupta

Hi guys. I had a quick macro question first. Can you talk about – a little bit about the limitations of very low-sulfur fuel oil at this stage? I'm trying to understand, would shippers be more comfortable sticking to the tried and tested marine gas oil or would they actually be looking at the very low-sulfur fuel oil as a cheaper substitute in the initial stages of IMO?

Gary Simmons

Yes. So we have a compliant blend that we are offering in the Corpus Christi market. We are also proceeding with the project, where we'll be able to have a low-sulfur blend in Pembroke. But we also have seen that there is a lot of challenges on being able to blend this 0.5 material especially with a lot of the low-sulfur Paraffinic crudes. So I think there is a good chance that initially ships will run marine gas oil and then gradually transition to the lower sulfur bunker material.

Manav Gupta

And as I understand, that would be good for the U.S. diesel demand, right, if they continue to use marine gas oil in the initial stages?

Gary Simmons

Yes, it will. And I think even with the blends we're seeing on the low-sulfur bunker material those when still contain a fairly significant percentage of distillate in the blend. And so even if they're burning the low-sulfur bunker, we still see a step change in diesel demand.

Manav Gupta

A quick follow-up is, you are running a lot of light sweet crude on the Gulf Coast, almost 770,000 barrels a day, up about 25% versus last year. I'm trying to understand now that we are finally seeing sour discounts widen out. Should we think that in 4Q and going ahead, there is a little bit of a switch back-to-medium and heavies, which would also solve some of the naphtha issues you had in 2Q?

Gary Simmons

Yes. So that's exactly what we see. We set another record for light sweet crude processing in the third quarter. The economic signals were strongly in favor of light sweet crude. We've been saying that we are at 1.6 million barrels a day of overall capacity and we pretty much fully utilized that in the third quarter. But certainly with the widening of the quality discount, especially the heavy sour crude are favored and we're starting to see medium sour crudes become economic as well.

Manav Gupta

Thank you for taking my questions, and congrats on another good quarter. Thank you.

Joe Gorder

Thanks, Manav. Take care.

Operator

Our next question comes from Phil Gresh with JP Morgan. Your line is now open.

Phil Gresh

Hey, good morning. A bit of a follow-up to Manav's question here, just in terms of your slate on the Gulf Coast, how do you think about, your ability to run high sulfur fuel oil as a feedstock? I think residuals have been about 200,000 barrels a day or so, each of the past few quarters. How much of that is high sulfur fuel oil and what kind of flexibility do you have to run more as a feedstock?

Gary Simmons

So we have a lot of flexibility to do that and we have been doing some of it backing out high sulfur or heavy sour crude. And we haven't really been running high sulfur fuel, but we've been running blend components that are going into the high sulfur fuel oil market. We've run some of those and we expect to do more as we move forward.

Phil Gresh

Okay. And then second question, obviously there is a change to the Maya formula, but obviously Maya has to be competitive regardless of what the formula is. I'm just curious how you think about – how these heavy barrels on the Gulf Coast need the price, especially WCS, which seems to be discounting more, as more barrels are coming via rail, but also then you have the Middle Eastern barrels, you have the medium sours. So how do you think about how these should all price relative to each other?

Gary Simmons

Yes. So we believe heavy Canadian in Maya should trade at approximately the same value. Obviously in September, PMI expected high sulfur fuel oil to trade much weaker and the formula had Maya really priced out of the market. But they made a correction in October and if you look at where both WCS and Maya are trading today, they are almost on top of each other, which is where we expect those to trade moving forward.

Phil Gresh

Okay, great. Thank you.

Joe Gorder

Thanks, Phil.

Operator

Our next question comes from Prashant Rao with Citigroup. Your line is now open.

Prashant Rao

Good morning. Thanks for taking the question.

Joe Gorder

Good morning, Prashant.

Prashant Rao

Good morning, Joe. After following up on Phil's question there, price on Maya and WCS is one factor and relatively how those are on top of each other. In market access, the barrels are moving down of the Gulf is another, as we look to Canada talking about rail above curtailment, we're starting to see – end of the curtailment start to roll off a little bit. It looks like, could we get a more Brent barrels of Canadian into the Gulf Coast market?

I just wanted to get a sense of what you're seeing out there and maybe give us a sense of what you can get on sort of a firm versus delivered basis for barrels and how does that play any further into kind of that Maya versus U.S. dynamic pricing of the curve?

Gary Simmons

Yes. So we're in ongoing negotiations with several producers in Western Canada on delivered rail volume. We have our Lucas rail facility that feed support Arthur refinery and a lot of capacity to run-heavy Canadian there. And we anticipate as we move through the fourth quarter, you will see rail volumes ramp up as – and we anticipate we'll buy those barrels delivered on something equivalent to the WCS or Maya equivalent in the Gulf.

Prashant Rao

Okay, great. And then other factor, another question is just a follow-up on the ethanol, that's a smaller segment, but I just wanted to get a sense of how you see the next couple of quarters playing out? And when we could start to see potentially EBIT going back into the black on ethanol? What do we need to see to sort of give us the first time post that that's swings to the positive, because obviously that could be incremental upside there too in the quarter's ahead if factors play out right?

Martin Parrish

So this is Martin. I think near-term October is looking a lot better than the third quarter did. What you've seen is the recent DoE data. What the issue has been is oversupply in the U.S. right. Inventory is just too low, which is pressuring margins. The production is trending lower, ethanol inventory now on the weekly data is 2.5 million barrels lower than this time last year.

And then long-term, we're still bullish. Ethanol is going to be in the U.S. gasoline mix for the long run. We expect to see some small incremental demand in the U.S. from higher octane and fuel efficiency standards and some small incremental demand from year round E15 sales. And then we expect, really the big thing we expect is a rebound and the export growth due to favorable blend economics, just the economics to blending ethanol and then these global renewable fuel mandates. So we still feel very constructive in the long-term and think that's going to be around the corner.

Prashant Rao

All right, thank you very much for the time. Appreciate it.

Operator

Our next question comes from Paul Cheng with Scotia Howard Weil. Your line is now open.

Paul Cheng

Hey guys, good morning.

Joe Gorder

Hi, Paul.

Paul Cheng

I think I have two questions. One, maybe is for Gary, I think. So I would try to stick to just two, not multiple. That before we sit, Gary, you mentioned that you haven't really fit the high sulfur, we sit directly to the Coker. Is that something that you guys believe technically, given the way economic you can do? And does it matter whether it's a delayed Coker or as a forward Coker.

Lane Riggs

Hey Paul, it's Lane. We've historically ran quite a – what Gary was talking about was we run a lot of outside blend stocks that go into a 3.5% fuel oil and we've always done that. And it's a part of the market that we feel like we understand technically maybe better than a lot of the people in the industry.

And one of the critical strategy is going into this, towards going in IMO have to make sure you keep connectivity between these feedstocks and the heavy crudes and we work really hard at doing that. There are technical challenges. They are around defaulting and some of the other things, but we are very focused on increasing amount of heavy sours that we run.

Paul Cheng

Lane, so you're saying that you won the heavy sour, the crude or you won the heavy sour we see, I'm sorry?

Lane Riggs

We do both, but your question was around resid and...

Paul Cheng

Right.

Lane Riggs

So the earlier question was, are you running more fuel oil and we don't really run fuel oil per se. What we run is we run the blend stocks that go into 3.5%. And so as you see that as people unwind that as a fuel, you're going to see more of these components around the world become available. And the key is going out there and understanding and technically and fitting into our system, which we're working very aggressively to do that.

Paul Cheng

How about the second part of my question, whether that make any difference that – whether it's a fully Coker or delayed Coker and your ability to won those?

Lane Riggs

Not really.

Paul Cheng

Not really, okay. And that Joe for – you have strong cash flow and continue to do so. Your balance sheet is in good shape, but given the uncertainty in the economy. Will that makes sense to move part of the free cash to pay down debt to really draw down the debt to a much lower level at some point that we may get hit by recession, we don't know when, but at some point in may?

Joe Gorder

Yes, it's a good question, Paul. I will let Donna speak to that.

Donna Titzman

No, I actually think our balance sheet is in good shape. We do have additional debt capacity to go. I don't think our ratings are in jeopardy. We have good liquidity today. So again, I'm not – don't believe that paying down debt right now is necessary.

Joe Gorder

Yes, there is really nothing to tell, Paul…

Donna Titzman

Well, it's very expensive. You're right, our next maturity is in 2025 and to try to get that called early with the expensive and uneconomical to us.

Paul Cheng

That's it. Thank you.

Joe Gorder

Thanks, Paul.

Operator

Our next question comes from Doug Leggate with Bank of America. Your line is now open.

Doug Leggate

Thank you and good morning everyone. Good morning, Joe.

Joe Gorder

How are you doing Doug?

Homer Bhullar

How are you Doug?

Doug Leggate

I should probably thank Paul for making room for the rest of us, so I thank them as well. So, I just go two quick questions, Joe. Obviously, IMO is the focus for the whole market right now. My question really is more about, this year perspective on duration of any perceived benefit. To give it, to explain my question will further, our view is that the industry can react to the product side it, with things like your VGO, reallocation and things of that nature. The stickier side of it seems to be on the sour feedstock.

So I just want to get your perspective as do you think that the product side of it is more sticky as well? In which case, what does it mean for like gasoline balance given what you described in your prepared remarks about VGO? Maybe explain your experience of what you've done with VGO and how you expect to operate going forward? And I've got a quick follow-up please.

Joe Gorder

Okay. Gary and Lane can speak to this. You know, Paul, I mean, Doug, excuse me, if you recall probably for 18 months or something, we've been talking about the first – the prospects from IMO and it's kind of shaping up the way that we had anticipated. The one issue and the guys can speak to this in addition to your question is, how do you solve the circumstances that IMO creates in the market, okay. Who comes in and solves the problem around the 3.5% weight fuel oil? So you guys want to speak to it in general and then…

Lane Riggs

Yes, I'll start and then of course, Gary, can always tune it up a little bit later here, we – Joe alluded to this, we sort of played out the way that we thought, and I think ultimately early on, you're going to have this demand for diesel. It will be interesting to see how long that goes. I mean, it could go on for quite some time depending on the technical difficulty of making those fuels. And we have seen some of that like Gary alluded to it. It is not an easy task to create to make all the fuels work from a compatibility perspective. But longer term, the 3.5% weight, I'm making that not having a home for it is a much – the capital – a much more capital intensive thing to try to work through.

And somebody alluded – was asking the question earlier about valuations of crude. What will be interesting is, right now, I would say these crudes are – to the extent that heavy sour and medium sour are running not – they're not being value based on an open culture, but they're being valued based on 3.5% weight. You could see it – you're going to see that disconnect even get greater. I don't know that we know – you can think about all the path to try to close that gap, but it all takes quite a bit of capital.

Gary Simmons

Yes, I think a lot of uncertainty. We certainly anticipated, you'd see scrubbers come online, but it appears there's a lot of technical issues around the scrubbers that maybe they don't come on as fast as what we thought. And then the other area here that would uncertainty is when does some of this production that's offline, some of these medium and heavy sour crudes, when do they come back on the market. So very difficult to give you a timeline.

Joe Gorder

But it's...

Doug Leggate

I think you were trying to answer it, go on Joe, sorry.

Joe Gorder

It's not a problem that's going to get resolved very quickly. I think, again we've always kind of played down the whole product side of this, but I think we've expected more on the feedstock side. We're seeing it in both right now, but this is going to take a while to solve.

Doug Leggate

Thanks for attempting to answer guys. I know it's a really tough one, but obviously constructive for you guys in particular. My follow-up and either Joe or Donna, whoever wants to take this, but the balance between buybacks and dividends, specific to Valero, you're operating better than any other refinery in the industry, frankly, in terms of your execution, you reliability, in terms of markets. You know consistency of delivering to the market, but your buyback and dividend is still pretty skewed I guess. What is the right level for that, especially as your share price goes up? I know you've always been pretty sensitive to buying back stock. When you get some kind of periodic strengthening in margins and obviously the industry. So do we see a step-up in the dividend or maybe a rebalancing of how you return cash? And I'll leave it there, thanks.

Joe Gorder

Yes, I'll let Donna talk to this. Because – I mean, Doug, obviously there is not a formulaic approach to how you do this, right. I mean, you've going to have your outlook for the market going forward. Obviously, we felt it has been pretty good, that's why we've had a significant dividend increases. We have had – and you want to be competitive from a yield perspective, not only with your peers but with the broader market. So all those things taken into consideration, but not as far as the mix…

Donna Titzman

Yes, so I mean we do view that dividend as it is very important part of the total shareholder return, but it's also important to us that it is sustainable. So we want it to be very competitive in the market generally and specifically against our peers. But we also want to be able to sustain that dividend through the earnings cycle. So we always continue to look at that mix. We always continue to review it.

Joe Gorder

Yes. And you noticed that we did more on the buyback side this quarter than we did the previous quarter. And we haven't altered our approach and when we say, we look at ratability plus, we look at buying on dips and frankly we had a situation where we're looking into a strong fourth quarter with the prospects for IMO. We said it's a good time to buy back more shares. So that's what we did in the third quarter. So we took advantage of an opportunity, and we'll do that going forward.

Doug Leggate

Would we expect the buyback to slow if you did – let's say, you were 20% higher, would you still be buying back your shares?

Joe Gorder

If we were 20% higher, it all goes to...

Doug Leggate

As you know, it's a cyclical business obviously. So you buy back. You know at some point is going to drop again probably, so I guess, how do you respond to continue strengthening?

Joe Gorder

So, well, we are going to adhere to our 40% to 50% payout ratio. And Doug, it doesn't make sense in this business to jostle things around on an ongoing basis. You set your target and you work to achieve and it gives you consistency, not only with what the financial markets are going to expect from you, but operationally what you can afford to invest in and how you can grow the business. And so that's why we said this, capital allocation framework in place several years ago and we have adhered to it totally since then and it seems to work out. So don't make any forecast dividend increases and at all, we just rely on the fact that we had told you what we're going to do and we're going to do it.

Doug Leggate

Great answer. Thanks Joe. Appreciate it.

Joe Gorder

You bet.

Operator

Our next question comes from Sam Margolin with Wolfe Research. Your line is now open.

Sam Margolin

Good morning everybody, hi.

Joe Gorder

Hi, Sam.

Sam Margolin

I have a follow-up on renewable diesel actually. It's – the location of the project you're evaluating a Port Arthur, in the context of the comment around feedstock constraints, can you just talk a little bit about why that location is a good one? It seems like you operate in places that might have more local biomass. Are you importing or is it the marketing thing or you're exporting? I'm asking because as this business scales be good to know just sort of the factors that you look at for performance?

Martin Parrish

Yes, this is Martin. I mean the thing that helps renewable diesel is being co-located with the refinery. So that's probably the primary thing we're looking at and in place where we can hit all the markets. So that really drives you to the Gulf Coast and were driven in the United States just because of the – the feedstock supply in the U.S. per installed base of renewable diesel is better than anywhere else in the world. So that's why we're heading to reviewing Port Arthur and doing the engineering analysis on it.

Sam Margolin

Okay, thanks. So it's a combination of placement and feedstock, thanks. That's helpful. And then, we're like six weeks since the uptake stabilizer went down in Saudi, people who count the ships coming out of the Gulf see stable exports. But can you talk a little bit about what you're seeing as far as high sulfur to sour crude supply, if there's been any change in mix from the Middle East as far as feedstock quality or crude quality that you're seeing in the interim here as that facility gets repaired?

Gary Simmons

Yes, Sam, this is Gary. We haven't really purchased any Saudi volume in quite some time. And so I can't really give you a comment. We're running some Iraqi and Kuwait. It's primarily due to the West Coast, which has been unaffected, but we don't see any Saudi volume coming into our system at all.

Sam Margolin

All right. Thanks so much.

Operator

Our next question comes from Brad Heffern with RBC. Your line is now open.

Brad Heffern

Hi, everyone. Question on exports. So when I was looking at the numbers for last year for the third quarter, I think you guys exported over 400,000 barrels a day. This year was just a little over 300,000, is that demand pull into the U.S. Is that export weakness or is there some other factor that I'm not thinking of?

Joe Gorder

Yes, Brad. I think you kind of hit on it. The only thing I would tell you is, Port Arthur is one of our large export locations and we were doing some dredging work on the dock there, which did limit us a little bit, but the big driver was what you pointed to, that's an optimization for us and it is demand pull and with the large life product inventory draws we saw in the U.S., we had a better net back going into the domestic markets and that's what drove it rather than lack of demand into the export markets.

Brad Heffern

Okay, got it. And then a question on refining OpEx. So this quarter just phenomenal number was $1.1 billion. When I think back a couple of years ago it used to be in the 900s or even the high 800 sometimes. Is there any underlying factor that's driven at higher OpEx number?

Joe Gorder

It's easier for me to sort of compare it to year-over-year by the way rigs. Our volumes were down in the third quarter, largely we had three external power failure, then we had the storm deal with they went through and affected our Port Arthur operations. Our volumes weren't as high as they were with these, part of that is just on per barrel basis, it's a little bit higher and then some other thing. We've changed what is in and out of our operations and we did have the MLP out, now it's back in. We have Diamond Green Diesel, which used to be in, it's out. So there are some changes like that has occurred over time as well.

Brad Heffern

Okay, nothing structural?

Joe Gorder

No, nothing structural.

Brad Heffern

Thank you.

Operator

Our next question comes from Jason Gabelman with Cowen. Your line is now open.

Jason Gabelman

Yes, hi, thanks for taking the questions. I wanted to follow-up on something Roger Read asked around, the higher shipping rates. Obviously, there are some near-term volatility in those rates, but I think the market is expecting shipping rates both on the crude and product side to be structurally higher than they were in kind of the first half of this year. Can you just talk from a totality perspective for Valero, how those higher rates impact the Company's earnings? I guess both on the product side and maybe lifting global refining margins and then also on the feedstock side in higher blended feedstock costs? Thanks.

Gary Simmons

Sure. I'll start on the feedstock side. Obviously with the – we've been running, we're running a lot of pipeline delivered crude and then a lot of the barrels were getting over the water, short haul barrel. So we don't see a big impact on our feedstock costs and similarly on the products, the barrels are going in the domestic markets, or we export to fairly short haul locations in Mexico and South America. So not a material impact. Some of the long-haul barrels that we do run, we do have some freight protection on those as well, which helps.

Obviously, the big thing that we've seen is been positive to the business, as freight rates is spiked, Joe mentioned in his opening comments that the Brent TI spread had come in with the pipeline capacity coming online, but with the freight rates spiking we've seen Brent TI blow back out some and back over $5, which obviously gives U.S. refining a significant advantage on running light sweet crude. And as I mentioned previously into our export location, when you're going to Mexico, the higher freight rates actually give us a competitive advantage over some of our global refining competitors trying to import to those markets.

Jason Gabelman

All right, thanks for that. I appreciate that color. And then if I could ask just on the Syncrude marketing kind of the northern crude market, because I know you guys run a decent amount Syncrude to Quebec. It seems like there's going to be some changes in the balances in terms of and operator maybe using less Syncrude for diluent and then the Northwest refinery up there switching from running Syncrude to WCS. Do you see a shift in kind of the pricing paradigm for Syncrude and maybe that bleeding into Bakken, emerging over the next few months into 2020?

Gary Simmons

Well, it's interesting. Syncrude obviously in an IMO environment could be a premium price crude. So we have a lot of optimization opportunities on what we spent through line nine and I think our view would probably see – we see a little bit more Bakken than we see syn going to Quebec as we move forward in an IMO environment.

Jason Gabelman

All right, thanks a lot.

Joe Gorder

Thanks, Jason.

Operator

Our next question comes from Patrick Flam with Simmons Energy. Your line is now open.

Patrick Flam

Good morning, thanks for taking the question. My first question is basically, I was hoping you guys could frame up your thoughts around the recent proposed changes to the RFS program. Obviously, you guys are partially hedged to any changes by way of your ethanol and bio-diesel operations, but it seems like any reallocation of volumes lost to small refinery exemptions, would kind of come back on you as a larger operators? I was hoping you could give some context to those changes politically?

Joe Gorder

All right. Jason is on.

Jason Fraser

Yes, hi, this is Jason. You're right. On October 15th, the EPA released their supplemental RVO asking for public comment on, included in the formula the prior three years average of SREs, but the DOE recommended be granted. I know that a lot of words there. That'd be about 580 million gallons or 770 million gallons. To put it on which prior three years to use and they ask for comments on both. And then these obligations will be reobligated on the other non-exempt refiners in addition to your normal share. You should get what you already get and then you get this on top.

So our industry and many members of Congress have been clear that reallocating SREs on the other obligated parties like this is unworkable and we view it as a violation of fundamental fairness to those of us who already bearing our burden onto the program. It then may also be illegal. It's especially frustrating because it has been shown time and again by the EIA on data that granting this SREs in the past, as they've done it with no reallocation has no negative effect on ethanol blending on actual liquid volume they got moved, but this is simply no real ethanol demand destruction.

Joe Gorder

So the reallocation, he was asking about the impact of the reallocation on us, so the SREs, I mean it obviously is going to cost more for us to comply with a larger volume obligation. It's not, I wouldn't call it material, but if it was $0.01, we wouldn't like it. So anyway, we're going to do what we can to help deal with this.

Patrick Flam

Okay, great, that's very helpful. Thank you. My second question is kind of a more detailed question back on the Diamond Green Diesel segment. It appears that in the third quarter sales volume came in pretty low and in order to meet that 750,000 gallons a day, full-year target, it seems like the fourth quarter will have to step up pretty materially. Is there any context, you can give around why that might be the case?

Jason Fraser

We had guidance for the full year of 750,000 and we still expect to make that. We expect a strong fourth quarter. We had a scheduled catalyst change in the third quarter and that's why we guided the 750,000 gallons per day for the year to begin with. So we feel pretty good about the numbers.

Patrick Flam

Okay, great. Thank you.

Joe Gorder

Thanks, Patrick.

Operator

Our next question comes from the line of Matthew Blair with Tudor Pickering Holt. Your line is now open.

Matthew Blair

Hey, good morning everyone. I was hoping you could give a sense of how your 2020 turnaround schedule compares to 2019?

Lane Riggs

Hi, Matthew. This is Lane Riggs. We don't give any real forward guidance to our turnaround schedule of the policy.

Matthew Blair

Okay. And then West Coast cracks got off to a great start in Q4, it have come down a little bit here. How have your two California refineries run so far this quarter and would you expect to capture all this upside?

Lane Riggs

Yes. This is Lane again. We ran pretty – we ran well and we continue to run well. We had one small blip on our San Francisco area refinery, but other than that it wasn't that meaningful to the performance around, they've been for run a pretty well through all this.

Matthew Blair

Sounds good. Thanks.

Operator

I'm showing no further questions in queue at this time. I'd like to turn the call back to Mr. Bhuller for closing remarks.

Homer Bhullar

Thanks guys. We appreciate everyone joining us today. Obviously, please feel free to reach out to the IR team if you have any further questions. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.