VALERO ENERGY CORP/TX
Form 10-Q
May 07, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
(Mark One)

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended March 31, 2015
OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _______________ to _______________

Commission File Number 1-13175
VALERO ENERGY CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	74-1828067
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

One Valero Way
San Antonio, Texas
(Address of principal executive offices)
78249
(Zip Code)
(210) 345-2000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer þ   Accelerated filer o   Non-accelerated filer o   Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

The number of shares of the registrant's only class of common stock, $0.01 par value, outstanding as of April 30, 2015 was 508,621,424.

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PART I – FINANCIAL INFORMATION
Item 1. Financial Statements

VALERO ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS
(Millions of Dollars, Except Par Value)

	March 31, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and temporary cash investments	$4,870	$3,689
Receivables, net	4,924	5,879
Inventories	6,666	6,623
Income taxes receivable	53	97
Deferred income taxes	121	162
Prepaid expenses and other	154	164
Total current assets	16,788	16,614
Property, plant, and equipment, at cost	36,021	35,933
Accumulated depreciation	(9,425)	(9,198)
Property, plant, and equipment, net	26,596	26,735
Deferred charges and other assets, net	2,357	2,201
Total assets	$45,741	$45,550
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of debt and capital lease obligations	$200	$606
Accounts payable	6,010	6,760
Accrued expenses	512	596
Taxes other than income taxes	1,052	1,209
Income taxes payable	546	433
Deferred income taxes	314	376
Total current liabilities	8,634	9,980
Debt and capital lease obligations, less current portion	7,224	5,780
Deferred income taxes	6,624	6,607
Other long-term liabilities	1,917	1,939
Commitments and contingencies		
Equity:		
Valero Energy Corporation stockholders' equity:		
Common stock, $0.01 par value; 1,200,000,000 shares authorized; 673,501,593 and 673,501,593 shares issued	7	7
Additional paid-in capital	7,083	7,116
Treasury stock, at cost; 163,184,575 and 159,202,872 common shares	(8,390)	(8,125)
Retained earnings	22,804	22,046
Accumulated other comprehensive loss	(730)	(367)
Total Valero Energy Corporation stockholders' equity	20,774	20,677
Noncontrolling interests	568	567
Total equity	21,342	21,244
Total liabilities and equity	$45,741	$45,550

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(Millions of Dollars, Except Per Share Amounts)
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Operating revenues	$21,330	$33,663
Costs and expenses:		
Cost of sales	18,163	30,630
Operating expenses:		
Refining	964	972
Ethanol	120	129
General and administrative expenses	147	160
Depreciation and amortization expense	441	421
Total costs and expenses	19,835	32,312
Operating income	1,495	1,351
Other income, net	24	15
Interest and debt expense, net of capitalized interest	(101)	(100)
Income from continuing operations before income tax expense	1,418	1,266
Income tax expense	450	429
Income from continuing operations	968	837
Loss from discontinued operations	—	(1)
Net income	968	836
Less: Net income attributable to noncontrolling interests	4	8
Net income attributable to Valero Energy Corporation stockholders	$964	$828
Net income attributable to Valero Energy Corporation stockholders:		
Continuing operations	$964	$829
Discontinued operations	—	(1)
Total	$964	$828
Earnings per common share:		
Continuing operations	$1.87	$1.55
Discontinued operations	—	—
Total	$1.87	$1.55
Weighted-average common shares outstanding (in millions)	513	531
Earnings per common share – assuming dilution:		
Continuing operations	$1.87	$1.54
Discontinued operations	—	—
Total	$1.87	$1.54
Weighted-average common shares outstanding – assuming dilution (in millions)	516	536
Dividends per common share	$0.40	$0.25

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Millions of Dollars)
(Unaudited)

	Three Months Ended March 31,	
	2015	2014
Net income	$968	$836
Other comprehensive income (loss):		
Foreign currency translation adjustment	(366)	(74)
Net gain (loss) on pension and other postretirement benefits	5	(2)
Net gain on derivative instruments designated and qualifying as cash flow hedges	—	4
Other comprehensive loss before income tax expense	(361)	(72)
Income tax expense related to items of other comprehensive loss	2	1
Other comprehensive loss	(363)	(73)
Comprehensive income	605	763
Less: Comprehensive income attributable to noncontrolling interests	4	8
Comprehensive income attributable to Valero Energy Corporation stockholders	$601	$755

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Millions of Dollars)
(Unaudited)

	Three Months Ended March 31, 2015	2014
Cash flows from operating activities:		
Net income	$968	$836
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	441	421
Deferred income tax expense (benefit)	(61)	88
Changes in current assets and current liabilities	57	(1,088)
Changes in deferred charges and credits and other operating activities, net	28	(13)
Net cash provided by operating activities	1,433	244
Cash flows from investing activities:		
Capital expenditures	(458)	(388)
Deferred turnaround and catalyst costs	(240)	(129)
Other investing activities, net	(15)	(41)
Net cash used in investing activities	(713)	(558)
Cash flows from financing activities:		
Proceeds from debt issuances	1,446	—
Repayment of debt	(402)	—
Proceeds from the exercise of stock options	15	24
Purchase of common stock for treasury	(325)	(226)
Common stock dividends	(206)	(133)
Distributions to public unitholders of Valero Energy Partners LP	(5)	(1)
Other financing activities, net	3	24
Net cash provided by (used in) financing activities	526	(312)
Effect of foreign exchange rate changes on cash	(65)	(19)
Net increase (decrease) in cash and temporary cash investments	1,181	(645)
Cash and temporary cash investments at beginning of period	3,689	4,292
Cash and temporary cash investments at end of period	$4,870	$3,647

See Condensed Notes to Consolidated Financial Statements.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

As used in this report, the terms “Valero,” “we,” “us,” or “our” may refer to Valero Energy Corporation, one or more of its consolidated subsidiaries, or all of them taken as a whole.

These unaudited financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities Exchange Act of 1934. Accordingly, they do not include all of the information and notes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal recurring nature unless disclosed otherwise. Financial information for the three months ended March 31, 2015 and 2014 included in these Condensed Notes to Consolidated Financial Statements is derived from our unaudited financial statements. Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

The balance sheet as of December 31, 2014 has been derived from our audited financial statements as of that date. For further information, refer to our financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2014.

Reclassification

In May 2014, we abandoned our Aruba Refinery, except for the associated crude oil and refined products terminal assets that we continue to operate. As a result, the refinery’s results of operations have been presented in this report as discontinued operations for the three months ended March 31, 2014. For the three months ended March 31, 2014, the Aruba Refinery had no operating revenues and a $1 million loss before income tax expense.

Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. On an ongoing basis, we review our estimates based on currently available information. Changes in facts and circumstances may result in revised estimates.

Discontinued Operations

In April 2014, the provisions of Accounting Standards Codification (ASC) Topic 205, “Presentation of Financial Statements,” and ASC Topic 360, “Property, Plant, and Equipment,” were amended to change the criteria for reporting discontinued operations. The provisions of these amendments modify the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have or will have a major effect on an entity’s operations and financial results. These amendments require additional disclosures about discontinued operations and new disclosures for other disposals of individually material components of an organization that do not meet the definition of a discontinued operation. In addition, the guidance allows companies to have significant continuing involvement and continuing cash flows with the discontinued operation. These provisions were effective prospectively for annual reporting periods beginning on or after December 15, 2014, and interim periods

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

within those annual periods, with early adoption permitted. The adoption of this guidance effective January 1, 2015 did not affect our financial position or results of operations; however, it may result in changes to the manner in which future dispositions of operations or assets, if any, are presented in our financial statements, or it may require additional disclosures.

New Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) amended the ASC and issued a new accounting standard, Topic 606, "Revenue from Contracts with Customers," to clarify the principles for recognizing revenue. The core principle of the new standard is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard also requires improved interim and annual disclosures that enable the users of financial statements to better understand the nature, amount, timing, and uncertainty of revenues and cash flows arising from contracts with customers. The new standard is effective for annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period, and can be adopted either retrospectively to each prior reporting period presented using a practical expedient, as allowed by the new standard, or retrospectively with a cumulative effect adjustment to retained earnings as of the date of initial application. Early adoption is not permitted. We are currently evaluating the effect that adopting this new standard will have on our financial statements and related disclosures.

In February 2015, the provisions of ASC Topic 810, "Consolidation" were amended to improve consolidation guidance for certain types of legal entities. The guidance modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities, eliminates the presumption that a general partner should consolidate a limited partnership, affects the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships, and provides a scope exception from consolidation guidance for certain money market funds. These provisions are effective for annual reporting periods beginning after December 15, 2015, and interim periods within those annual periods, with early adoption permitted. These provisions may also be adopted retrospectively in previously issued financial statements for one or more years with a cumulative-effect adjustment to retained earnings as of the beginning of the first year restated. The adoption of this guidance effective January 1, 2016 will not affect our financial position or results of operations, but will result in additional disclosures.

In April 2015, the provisions of ASC Subtopic 835-30, "Interest–Imputation of Interest" were amended to simplify the presentation of debt issuance costs. The guidance requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, and that amortization of debt issuance costs be reported as interest expense. These provisions are to be applied retrospectively and are effective for annual reporting periods beginning after December 15, 2015, and interim periods within those annual periods, with early adoption permitted. The adoption of this guidance effective January 1, 2016 will not materially affect our financial position or results of operations; however, our debt issuance costs will be reported in the balance sheet as a direct deduction from "debt and capital lease obligations, less current portion" and excluded from "deferred charges and other assets, net."

Also in April 2015, the provisions of ASC Topic 715, "Compensation–Retirement Benefits" were amended to provide a practical expedient for the measurement date of an entities' defined benefit pension or other

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

postretirement plans. For an entity with a fiscal year-end that does not coincide with a month-end, the guidance provides a practical expedient that allows the entity to measure the defined benefit plan assets and obligations using the month-end that is closest to the entity's fiscal year-end. For an entity that has a significant event in an interim period that calls for a remeasurement, the guidance allows an entity to remeasure the defined benefit plan assets and obligations using the month-end that is closest to the date of the significant event. These provisions are effective retrospectively for annual reporting periods beginning after December 15, 2015, and interim periods within those annual periods, with early adoption permitted. The adoption of this guidance effective January 1, 2016 will not affect our financial position or results of operations.

2. VALERO ENERGY PARTNERS LP

Valero Energy Partners LP (VLP) is a publicly traded master limited partnership that we formed to own, operate, develop, and acquire crude oil and refined petroleum products pipelines, terminals, and other transportation and logistics assets. As of March 31, 2015, VLP's assets included crude oil and refined products pipeline and terminal systems in the U.S. Gulf Coast and U.S. Mid-Continent regions that are integral to the operations of seven of our refineries.

Effective March 1, 2015, we sold to VLP our Houston and St. Charles Terminal Services Business, which owns and operates crude oil, intermediates, and refined products terminals supporting our Houston and St. Charles Refineries. We received (i) cash consideration of $571 million and (ii) 1,908,100 common units representing limited partner interests in VLP and 38,941 general partner units representing general partner interests in VLP having an aggregate value of $100 million. A portion of the cash consideration was funded through a $200 million borrowing by VLP under its revolving credit facility. The remaining cash consideration was funded with $211 million of VLP's cash on hand and a $160 million borrowing under a subordinated credit agreement between VLP and us, which is eliminated in consolidation as further described below.

The ownership of VLP consisted of the following:

	March 31, 2015		December 31, 2014	
Valero:				
Limited partner interest	69.6	%	68.6	%
General partner interest	2.0	%	2.0	%
Public:				
Limited partner interest	28.4	%	29.4	%

We consolidate the financial statements of VLP into our financial statements and as such, VLP's cash and temporary cash investments are included in our consolidated cash and temporary cash investments. However, VLP's cash and temporary cash investments can be used only to settle its obligations. VLP's cash and temporary cash investments were $28 million and $237 million as of March 31, 2015 and December 31, 2014, respectively. In addition, VLP's partnership capital attributable to the public's ownership interest in VLP of $377 million and $375 million as of March 31, 2015 and December 31, 2014, respectively, is reflected in noncontrolling interests.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

We have agreements with VLP that establish fees for certain general and administrative services, and operational and maintenance services provided by us. In addition, we have a master transportation services agreement and a master terminal services agreement with VLP under which VLP provides commercial pipeline transportation and terminaling services to us. These transactions are eliminated in consolidation.

3. INVENTORIES

Inventories consisted of the following (in millions):

	March 31, 2015	December 31, 2014
Refinery feedstocks	$2,646	$2,269
Refined products and blendstocks	3,554	3,926
Ethanol feedstocks and products	231	195
Materials and supplies	235	233
Inventories	$6,666	$6,623

As of March 31, 2015 and December 31, 2014, the replacement cost (market value) of last in, first out (LIFO) inventories exceeded their LIFO carrying amounts by $1.8 billion and $857 million, respectively. As of March 31, 2015 and December 31, 2014, our non-LIFO inventories accounted for $884 million and $906 million, respectively, of our total inventories.

4. DEBT

Credit Facilities

Revolver

We have a $3 billion revolving credit facility (the Revolver) that matures in November 2018. We have the option to increase the aggregate commitments under the Revolver to $4.5 billion, subject to, among other things, the consent of the existing lenders whose commitments will be increased or any additional lenders providing such additional capacity. The Revolver has certain restrictive covenants, including a maximum debt-to-capitalization ratio of 60 percent. As of March 31, 2015 and December 31, 2014, we were in compliance with the Revolver’s restrictive covenants.

VLP Revolver

VLP has a $300 million senior unsecured revolving credit facility agreement (the VLP Revolver) that matures in December 2018. The VLP Revolver is available only to the operations of VLP, and creditors of VLP do not have recourse against Valero.

Canadian Revolver

One of our Canadian subsidiaries has a C$50 million committed revolving credit facility (the Canadian Revolver) that matures in November 2015.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Activities Under Our Credit Facilities

During the three months ended March 31, 2015 and 2014, we had no borrowings or repayments under the Revolver or the Canadian Revolver. During the three months ended March 31, 2015, VLP borrowed $200 million under the VLP Revolver at an interest rate of 1.4375 percent in connection with VLP's acquisition of the Houston and St. Charles Terminal Services Business, as further discussed in Note 2, and had no repayments. There were no borrowings or repayments under the VLP Revolver during the the three months ended March 31, 2014. As of March 31, 2015 and December 31, 2014, we had no borrowings outstanding under the Revolver or the Canadian Revolver. As of March 31, 2015, VLP had $200 million of borrowings outstanding under the VLP Revolver, and no amounts outstanding as of December 31, 2014.

Letters of Credit

We had outstanding letters of credit under our committed credit facilities as follows (in millions):

	Borrowing Capacity	Expiration	Amounts Outstanding March 31, 2015	Amounts Outstanding December 31, 2014
Letter of credit facilities	$ 550	June 2015	$ —	$ 56
Revolver	$ 3,000	November 2018	$ 64	$ 54
VLP Revolver	$ 300	December 2018	$ —	$ —
Canadian Revolver	C$50	November 2015	C$10	C$10

As of March 31, 2015 and December 31, 2014, we had $204 million and $80 million, respectively, of letters of credit outstanding under our uncommitted short-term bank credit facilities.

Non-Bank Debt

During the three months ended March 31, 2015, we issued $600 million of 3.65 percent senior notes due March 15, 2025 and $650 million of 4.9 percent senior notes due March 15, 2045. Proceeds from these debt issuances totaled $1.246 billion. We also incurred $12 million of debt issuance costs.

In addition, we made a scheduled debt repayment of $400 million related to our 4.5 percent senior notes during the three months ended March 31, 2015. We made no scheduled debt repayments during the three months ended March 31, 2014.

Accounts Receivable Sales Facility

We have an accounts receivable sales facility with a group of third-party entities and financial institutions to sell up to $1.5 billion of eligible trade receivables on a revolving basis. This facility matures in July 2015. Proceeds from the sale of receivables under this facility are reflected as debt. Under this program, one of our marketing subsidiaries (Valero Marketing) sells eligible receivables, without recourse, to another of our subsidiaries (Valero Capital), whereupon the receivables are no longer owned by Valero Marketing. Valero Capital, in turn, sells an undivided percentage ownership interest in the eligible receivables, without recourse, to the third-party entities and financial institutions. To the extent that Valero Capital retains an ownership interest in the receivables it has purchased from Valero Marketing, such interest is included in our financial statements solely as a result of the consolidation of the financial statements of Valero Capital with those of Valero Energy Corporation; the receivables are not available to satisfy the claims of the creditors of Valero Marketing or Valero Energy Corporation.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

During the three months ended March 31, 2015 and 2014, we had no proceeds from or repayments under our accounts receivable sales facility. As of March 31, 2015 and December 31, 2014, we had $100 million outstanding under our accounts receivable sales facility.

Capitalized Interest
Capitalized interest was $16 million and $17 million for the three months ended March 31, 2015 and 2014, respectively.

5. COMMITMENTS AND CONTINGENCIES

Environmental Matters
We are involved, together with several other companies, in an environmental cleanup in the Village of Hartford, Illinois (the Village) and the adjacent shutdown refinery site, which we acquired as part of an acquisition in 2005. We have been conducting initial mitigation and cleanup with other companies pursuant to an administrative order issued by the U.S. Environmental Protection Agency (EPA). The U.S. EPA is seeking further cleanup obligations from us and other potentially responsible parties (PRPs) for the Village. In parallel with the Village cleanup, we are in litigation with the Illinois EPA and other PRPs relating to the remediation of the shutdown refinery site. In each of these matters, we have various defenses and rights for contribution from the other responsible parties. We have accrued for our own expected contribution obligations. However, because of the unpredictable nature of these cleanups and the methodology for allocation of liabilities, it is reasonably possible that we could incur a loss in a range of $0 to $200 million in excess of the amount of our accrual to ultimately resolve these matters. Factors underlying this estimated range are expected to change from time to time, and actual results may vary significantly from this estimate.

Litigation Matters
We are party to claims and legal proceedings arising in the ordinary course of business. We have not recorded a loss contingency liability with respect to some of these matters because we have determined that it is remote that a loss has been incurred. For other matters, we have recorded a loss contingency liability where we have determined that it is probable that a loss has been incurred and that the loss is reasonably estimable. These loss contingency liabilities are not material to our financial position. We re-evaluate and update our loss contingency liabilities as matters progress over time, and we believe that any changes to the recorded liabilities will not be material to our financial position, results of operations, or liquidity.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. EQUITY

Reconciliation of Balances
The following is a reconciliation of the beginning and ending balances of equity attributable to our stockholders, equity attributable to the noncontrolling interests, and total equity (in millions):

	Three Months Ended March 31,					
	2015			2014		
	Valero Stockholders' Equity	Non-controlling Interests	Total Equity	Valero Stockholders' Equity	Non-controlling Interests	Total Equity
Balance as of beginning of period	$20,677	$567	$21,244	$19,460	$486	$19,946
Net income	964	4	968	828	8	836
Dividends	(206)	—	(206)	(133)	—	(133)
Stock-based compensation expense	9	—	9	10	—	10
Tax deduction in excess of stock-based compensation expense	15	—	15	25	—	25
Transactions in connection with stock-based compensation plans:						
Stock issuances	15	—	15	24	—	24
Stock repurchases	(50)	—	(50)	(17)	—	(17)
Stock repurchases under buyback program	(287)	—	(287)	(209)	—	(209)
Contributions from noncontrolling interests	—	2	2	—	—	—
Distributions to public unitholders of Valero Energy Partners LP	—	(5)	(5)	—	(1)	(1)
Other comprehensive loss	(363)	—	(363)	(73)	—	(73)
Balance as of end of period	$20,774	$568	$21,342	$19,915	$493	$20,408

The noncontrolling interests relate to third-party ownership interests in VLP and joint venture companies whose financial statements we consolidate due to our controlling interests.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Share Activity
Activity in the number of shares of common stock and treasury stock was as follows (in millions):

	Three Months Ended March 31,			
	2015		2014	
	Common Stock	Treasury Stock	Common Stock	Treasury Stock
Balance as of beginning of period	673	(159)	673	(138)
Transactions in connection with stock-based compensation plans:				
Stock issuances	—	2	—	2
Stock repurchases	—	(1)	—	—
Stock repurchases under buyback program	—	(5)	—	(4)
Balance as of end of period	673	(163)	673	(140)

Treasury Stock
During April 2015, we purchased 1.7 million shares of our common stock for $104 million, $76 million of which was purchased under our stock purchase program.

Common Stock Dividends
On April 30, 2015, our board of directors declared a quarterly cash dividend of $0.40 per common share payable on June 10, 2015 to holders of record at the close of business on May 13, 2015.

Income Tax Effects Related to Components of Other Comprehensive Loss
The tax effects allocated to each component of other comprehensive loss were as follows (in millions):

	Three Months Ended March 31,					
	2015			2014		
	Before-Tax Amount	Tax Expense (Benefit)	Net Amount	Before-Tax Amount	Tax Expense (Benefit)	Net Amount
Foreign currency translation adjustment	$(366)	$—	$(366)	$(74)	$—	$(74)
Pension and other postretirement benefits:						
Amounts reclassified into income related to:						
Net actuarial loss	15	5	10	8	3	5
Prior service credit	(10)	(3)	(7)	(10)	(3)	(7)
Net gain (loss) on pension and other postretirement benefits	5	2	3	(2)	—	(2)
Derivative instruments designated and qualifying as cash flow hedges:						
Net gain arising during the period	—	—	—	7	2	5
Net gain reclassified into income	—	—	—	(3)	(1)	(2)
Net gain on cash flow hedges	—	—	—	4	1	3
Other comprehensive loss	$(361)	$2	$(363)	$(72)	$1	$(73)

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accumulated Other Comprehensive Income (Loss)

Changes in accumulated other comprehensive income (loss) by component, net of tax, were as follows (in millions):

	Foreign Currency Translation Adjustment	Defined Benefit Plans Items	Gains and (Losses) on Cash Flow Hedges	Total
Balance as of December 31, 2014	$1	$(368)	$—	$(367)
Other comprehensive loss before reclassifications	(366)	—	—	(366)
Amounts reclassified from accumulated other comprehensive loss	—	3	—	3
Net other comprehensive income (loss)	(366)	3	—	(363)
Balance as of March 31, 2015	$(365)	$(365)	$—	$(730)

	Foreign Currency Translation Adjustment	Defined Benefit Plans Items	Gains and (Losses) on Cash Flow Hedges	Total
Balance as of December 31, 2013	$408	$(58)	$—	$350
Other comprehensive income (loss) before reclassifications	(74)	—	5	(69)
Amounts reclassified from accumulated other comprehensive income (loss)	—	(2)	(2)	(4)
Net other comprehensive income (loss)	(74)	(2)	3	(73)
Balance as of March 31, 2014	$334	$(60)	$3	$277

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. EMPLOYEE BENEFIT PLANS

The components of net periodic benefit cost related to our defined benefit plans were as follows (in millions):

	Pension Plans		Other Postretirement Benefit Plans	
	2015	2014	2015	2014
Three months ended March 31:				
Service cost	$27	$30	$2	$2
Interest cost	24	23	4	4
Expected return on plan assets	(33)	(33)	—	—
Amortization of:				
Prior service credit	(5)	(5)	(5)	(5)
Net actuarial loss	16	8	—	—
Net periodic benefit cost	$29	$23	$1	$1

Our anticipated contributions to our pension and other postretirement benefit plans during 2015 have not changed from amounts previously disclosed in our financial statements for the year ended December 31, 2014. We contributed $7 million and $10 million, respectively, to our pension plans and $2 million and $4 million, respectively, to our other postretirement benefit plans during the three months ended March 31, 2015 and 2014.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. EARNINGS PER COMMON SHARE

Earnings per common share were computed as follows (dollars and shares in millions, except per share amounts):

	Three Months Ended March 31,			
	2015		2014	
	Participating Securities	Common Stock	Participating Securities	Common Stock
Earnings per common share from continuing operations:				
Net income attributable to Valero stockholders from continuing operations		$964		$829
Less dividends paid:				
Common stock		205		132
Participating securities		1		1
Undistributed earnings		$758		$696
Weighted-average common shares outstanding	2	513	2	531
Earnings per common share from continuing operations:				
Distributed earnings	$0.40	$0.40	$0.25	$0.25
Undistributed earnings	1.47	1.47	1.30	1.30
Total earnings per common share from continuing operations	$1.87	$1.87	$1.55	$1.55
Earnings per common share from continuing operations – assuming dilution:				
Net income attributable to Valero stockholders from continuing operations		$964		$829
Weighted-average common shares outstanding		513		531
Common equivalent shares:				
Stock options		2		3
Performance awards and nonvested restricted stock		1		2
Weighted-average common shares outstanding – assuming dilution		516		536
Earnings per common share from continuing operations – assuming dilution		$1.87		$1.54

Participating securities include restricted stock and performance awards granted under our 2011 Omnibus Stock Incentive Plan.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. SEGMENT INFORMATION

The following table reflects activity related to our reportable segments (in millions):

	Refining	Ethanol	Corporate	Total
Three months ended March 31, 2015:				
Operating revenues from external customers	$20,529	$801	$—	$21,330
Intersegment revenues	—	28	—	28
Operating income (loss)	1,641	12	(158)	1,495
Three months ended March 31, 2014:				
Operating revenues from external customers	32,452	1,211	—	33,663
Intersegment revenues	—	25	—	25
Operating income (loss)	1,280	243	(172)	1,351

Total assets by reportable segment were as follows (in millions):

	March 31, 2015	December 31, 2014
Refining	$38,857	$40,103
Ethanol	986	954
Corporate	5,898	4,493
Total assets	$45,741	$45,550

VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

10. SUPPLEMENTAL CASH FLOW INFORMATION

In order to determine net cash provided by operating activities, net income is adjusted by, among other things, changes in current assets and current liabilities as follows (in millions):

	Three Months Ended March 31,	
	2015	2014
Decrease (increase) in current assets:		
Receivables, net	$892	$958
Inventories	(166)	(1,356)
Income taxes receivable	39	(31)
Prepaid expenses and other	8	—
Increase (decrease) in current liabilities:		
Accounts payable	(688)	(299)
Accrued expenses	(80)	(50)
Taxes other than income taxes	(107)	(198)
Income taxes payable	159	(112)
Changes in current assets and current liabilities	$57	$(1,088)

The above changes in current assets and current liabilities differ from changes between amounts reflected in the applicable balance sheets for the respective periods for the following reasons:

- the amounts shown above exclude changes in cash and temporary cash investments, deferred income taxes, and current portion of debt and capital lease obligations, as well as the effect of certain noncash investing and financing activities discussed below;
- amounts accrued for capital expenditures and deferred turnaround and catalyst costs are reflected in investing activities when such amounts are paid;
- amounts accrued for common stock purchases in the open market that are not settled as of the balance sheet date are reflected in financing activities when the purchases are settled and paid; and
- certain differences between balance sheet changes and the changes reflected above result from translating foreign currency denominated balances at the applicable exchange rates as of each balance sheet date.

There were no significant noncash investing or financing activities for the three months ended March 31, 2015 and 2014.

Cash flows related to interest and income taxes were as follows (in millions):

	Three Months Ended March 31,	
	2015	2014
Interest paid in excess of amount capitalized	$78	$74
Income taxes paid, net	298	459

VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Cash flows related to the discontinued operations of the Aruba Refinery were immaterial for the three months ended March 31, 2014.

11. FAIR VALUE MEASUREMENTS

General

U.S. GAAP requires or permits certain assets and liabilities to be measured at fair value on a recurring or nonrecurring basis in our balance sheets, and those assets and liabilities are presented below under “Recurring Fair Value Measurements” and “Nonrecurring Fair Value Measurements.” Assets and liabilities measured at fair value on a recurring basis, such as derivative financial instruments, are measured at fair value at the end of each reporting period. Assets and liabilities measured at fair value on a nonrecurring basis, such as the impairment of property, plant and equipment, are measured at fair value in particular circumstances.

U.S. GAAP also requires the disclosure of the fair values of financial instruments when an option to elect fair value accounting has been provided, but such election has not been made. A debt obligation is an example of such a financial instrument. The disclosure of the fair values of financial instruments not recognized at fair value in our balance sheet is presented below under “Other Financial Instruments.”

U.S. GAAP provides a framework for measuring fair value and establishes a three-level fair value hierarchy that prioritizes inputs to valuation techniques based on the degree to which objective prices in external active markets are available to measure fair value. Following is a description of each of the levels of the fair value hierarchy.

- Level 1 - Observable inputs, such as unadjusted quoted prices in active markets for identical assets or liabilities.
- Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3 - Unobservable inputs for the asset or liability. Unobservable inputs reflect our own assumptions about what market participants would use to price the asset or liability. The inputs are developed based on the best information available in the circumstances, which might include occasional market quotes or sales of similar instruments or our own financial data such as internally developed pricing models, discounted cash flow methodologies, as well as instruments for which the fair value determination requires significant judgment.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Recurring Fair Value Measurements
The tables below present information (in millions) about our assets and liabilities recognized at their fair values in our balance sheets categorized according to the fair value hierarchy of the inputs utilized by us to determine the fair values as of March 31, 2015 and December 31, 2014.

We have elected to offset the fair value amounts recognized for multiple similar derivative contracts executed with the same counterparty, including any related cash collateral assets or obligations as shown below; however, fair value amounts by hierarchy level are presented on a gross basis in the tables below. We have no derivative contracts that are subject to master netting arrangements that are reflected gross on the balance sheet.

	March 31, 2015							
	Fair Value Hierarchy			Total Gross Fair Value	Effect of Counter-party Netting	Effect of Cash Collateral Netting	Net Carrying Value on Balance Sheet	Cash Collateral Paid or Received Not Offset
	Level 1	Level 2	Level 3					
Assets:								
Commodity derivative contracts	$2,438	$30	$—	$2,468	$(2,443)	$—	$25	$—
Foreign currency contracts	3	—	—	3	n/a	n/a	3	n/a
Investments of certain benefit plans	91	—	11	102	n/a	n/a	102	n/a
Total	$2,532	$30	$11	$2,573	$(2,443)	$—	$130	
Liabilities:								
Commodity derivative contracts	$2,455	$34	$—	$2,489	$(2,443)	$(46)	$—	$(155)
Environmental credit obligations	—	43	—	43	n/a	n/a	43	n/a
Physical purchase contracts	—	4	—	4	n/a	n/a	4	n/a
Total	$2,455	$81	$—	$2,536	$(2,443)	$(46)	$47	

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	December 31, 2014							
	Fair Value Hierarchy			Total Gross Fair Value	Effect of Counter-party Netting	Effect of Cash Collateral Netting	Net Carrying Value on Balance Sheet	Cash Collateral Paid or Received Not Offset
	Level 1	Level 2	Level 3					
Assets:								
Commodity derivative contracts	$3,096	$36	$—	$3,132	$(2,907)	$(99)	$126	$—
Physical purchase contracts	—	1	—	1	n/a	n/a	1	n/a
Investments of certain benefit plans	97	—	11	108	n/a	n/a	108	n/a
Total	$3,193	$37	$11	$3,241	$(2,907)	$(99)	$235	
Liabilities:								
Commodity derivative contracts	$2,886	$34	$—	$2,920	$(2,907)	$(13)	$—	$(25)
Environmental credit obligations	—	14	—	14	n/a	n/a	14	n/a
Physical purchase contracts	—	5	—	5	n/a	n/a	5	n/a
Total	$2,886	$53	$—	$2,939	$(2,907)	$(13)	$19	

A description of our assets and liabilities recognized at fair value along with the valuation methods and inputs we used to develop their fair value measurements are as follows:

- Commodity derivative contracts consist primarily of exchange-traded futures and swaps, and as disclosed in Note 12, some of these contracts are designated as hedging instruments. These contracts are measured at fair value using the market approach. Exchange-traded futures are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy. Swaps are priced using third-party broker quotes, industry pricing services, and exchange-traded curves, with appropriate consideration of counterparty credit risk, but because they have contractual terms that are not identical to exchange-traded futures instruments with a comparable market price, these financial instruments are categorized in Level 2 of the fair value hierarchy.
- Physical purchase contracts represent the fair value of firm commitments to purchase crude oil feedstocks and the fair value of fixed-price corn purchase contracts, and as disclosed in Note 12, some of these contracts are designated as hedging instruments. The fair values of these firm commitments and purchase contracts are measured using a market approach based on quoted prices from the commodity exchange or an independent pricing service and are categorized in Level 2 of the fair value hierarchy.
- Investments of certain benefit plans consist of investment securities held by trusts for the purpose of satisfying a portion of our obligations under certain U.S. nonqualified benefit plans. The assets categorized in Level 1 of the fair value hierarchy are measured at fair value using a market approach based on quoted prices from national securities exchanges. The assets categorized in Level 3 of the fair value hierarchy represent insurance contracts, the fair value of which is provided by the insurer.
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Foreign currency contracts consist of foreign currency exchange and purchase contracts entered into for our international operations to manage our exposure to exchange rate fluctuations on transactions

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

denominated in currencies other than the local (functional) currencies of those operations. These contracts are valued based on quoted prices from the exchange and are categorized in Level 1 of the fair value hierarchy.

- Environmental credit obligations represent our liability for the purchase of (i) biofuel credits (primarily Renewable Identification Numbers (RINs) in the U.S.) needed to satisfy our obligation to blend biofuels into the products we produce and (ii) emission credits under the California Global Warming Solutions Act (the California cap-and-trade system, also known as AB 32) and Quebec’s Regulation respecting the cap-and-trade system for greenhouse gas emission allowances (the Quebec cap-and-trade system), collectively, the cap-and-trade systems. To the degree we are unable to blend biofuels (such as ethanol and biodiesel) at percentages required under the biofuel programs, we must purchase biofuel credits to comply with these programs. Under the cap-and-trade systems, we must purchase emission credits to comply with these systems. These programs are further described in Note 12 under “Compliance Program Price Risk.” The liability for environmental credits is based on our deficit for such credits as of the balance sheet date, if any, after considering any credits acquired or under contract, and is equal to the product of the credits deficit and the market price of these credits as of the balance sheet date. The environmental credit obligations are categorized in Level 2 of the fair value hierarchy and are measured at fair value using the market approach based on quoted prices from an independent pricing service.

There were no transfers between Level 1 and Level 2 for assets and liabilities held as of March 31, 2015 and December 31, 2014 that were measured at fair value on a recurring basis.

There was no activity during the three months ended March 31, 2015 and 2014 related to the fair value amounts categorized in Level 3 as of March 31, 2015 and December 31, 2014.

Nonrecurring Fair Value Measurements

There were no assets or liabilities that were measured at fair value on a nonrecurring basis as of March 31, 2015 and December 31, 2014.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Financial Instruments

Financial instruments that we recognize in our balance sheets at their carrying amounts are shown in the table below (in millions):

	March 31, 2015		December 31, 2014	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and temporary cash investments	$4,870	$4,870	$3,689	$3,689
Financial liabilities:				
Debt (excluding capital leases)	7,393	8,798	6,354	7,562

The methods and significant assumptions used to estimate the fair value of these financial instruments are as follows:

- The fair value of cash and temporary cash investments approximates the carrying value due to the low level of credit risk of these assets combined with their short maturities and market interest rates (Level 1).
- The fair value of debt is determined primarily using the market approach based on quoted prices provided by third-party brokers and vendor pricing services (Level 2).

VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. PRICE RISK MANAGEMENT ACTIVITIES

We are exposed to market risks related to the volatility in the price of commodities, interest rates, and foreign currency exchange rates. We enter into derivative instruments to manage some of these risks, including derivative instruments related to the various commodities we purchase or produce, interest rate swaps, and foreign currency exchange and purchase contracts, as described below under “Risk Management Activities by Type of Risk.” These derivative instruments are recorded as either assets or liabilities measured at their fair values (see Note 11), as summarized below under “Fair Values of Derivative Instruments.” In addition, the effect of these derivative instruments on our income is summarized below under “Effect of Derivative Instruments on Income and Other Comprehensive Income.”

When we enter into a derivative instrument, it is designated as a fair value hedge, a cash flow hedge, an economic hedge, or a trading derivative. The gain or loss on a derivative instrument designated and qualifying as a fair value hedge, as well as the offsetting loss or gain on the hedged item attributable to the hedged risk, is recognized currently in income in the same period. The effective portion of the gain or loss on a derivative instrument designated and qualifying as a cash flow hedge is initially reported as a component of other comprehensive income and is then recorded into income in the period or periods during which the hedged forecasted transaction affects income. The ineffective portion of the gain or loss on the cash flow derivative instrument, if any, is recognized in income as incurred. For our economic hedges (derivative instruments not designated as fair value or cash flow hedges) and for derivative instruments entered into by us for trading purposes, the derivative instrument is recorded at fair value and changes in the fair value of the derivative instrument are recognized currently in income. The cash flow effects of all of our derivative instruments are reflected in operating activities in our statements of cash flows for all periods presented.

We are also exposed to market risk related to the volatility in the price of credits needed to comply with various governmental and regulatory programs. To manage this risk, we enter into contracts to purchase these credits when prices are deemed favorable. Some of these contracts are derivative instruments; however, we elect the normal purchase exception and do not record these contracts at their fair values.

Risk Management Activities by Type of Risk
Commodity Price Risk
We are exposed to market risks related to the volatility in the price of crude oil, refined products (primarily gasoline and distillate), grain (primarily corn), soybean oil, and natural gas used in our operations. To reduce the impact of price volatility on our results of operations and cash flows, we use commodity derivative instruments, including futures, swaps, and options. We use the futures markets for the available liquidity, which provides greater flexibility in transacting our hedging and trading operations. We use swaps primarily to manage our price exposure. Our positions in commodity derivative instruments are monitored and managed on a daily basis by a risk control group to ensure compliance with our stated risk management policy that has been approved by our board of directors.

For risk management purposes, we use fair value hedges, cash flow hedges, and economic hedges. In addition to the use of derivative instruments to manage commodity price risk, we also enter into certain commodity derivative instruments for trading purposes. Our objective for entering into each type of hedge or trading derivative is described below.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- Fair Value Hedges – Fair value hedges are used to hedge price volatility in certain refining inventories and firm commitments to purchase inventories. The level of activity for our fair value hedges is based on the level of our operating inventories, and generally represents the amount by which our inventories differ from our previous year-end LIFO inventory levels. As of March 31, 2015, we had no outstanding commodity derivative instruments that were entered into as fair value hedges.

- Cash Flow Hedges – Cash flow hedges are used to hedge price volatility in certain forecasted feedstock and refined product purchases, refined product sales, and natural gas purchases. The objective of our cash flow hedges is to lock in the price of forecasted feedstock, refined product, or natural gas purchases or refined product sales at existing market prices that we deem favorable. As of March 31, 2015, we had no outstanding commodity derivative instruments that were entered into as cash flow hedges.

- Economic Hedges – Economic hedges represent commodity derivative instruments that are not designated as fair value or cash flow hedges and are used to manage price volatility in certain (i) feedstock and refined product inventories, (ii) forecasted feedstock and product purchases, and product sales, and (iii) fixed-price purchase contracts. Our objective for entering into economic hedges is consistent with the objectives discussed above for fair value hedges and cash flow hedges. However, the economic hedges are not designated as a fair value hedge or a cash flow hedge for accounting purposes, usually due to the difficulty of establishing the required documentation at the date that the derivative instrument is entered into that would allow us to achieve “hedge deferral accounting.”

As of March 31, 2015, we had the following outstanding commodity derivative instruments that were used as economic hedges, as well as commodity derivative instruments related to the physical purchase of corn at a fixed price. The information presents the notional volume of outstanding contracts by type of instrument and year of maturity (volumes in thousands of barrels, except those identified as corn contracts that are presented in thousands of bushels and soybean oil contracts that are presented in thousands of pounds).

	Notional Contract Volumes by Year of Maturity	
Derivative Instrument	2015	2016
Crude oil and refined products:		
Swaps – long	10,404	—
Swaps – short	9,808	—
Futures – long	48,405	11
Futures – short	55,761	—
Corn:		
Futures – long	16,070	80
Futures – short	35,590	1,510
Physical contracts – long	16,786	1,437
Soybean oil:		
Futures – long	113,820	—
Futures – short	263,280	—

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- Trading Derivatives – Our objective for entering into commodity derivative instruments for trading purposes is to take advantage of existing market conditions related to future results of operations and cash flows.

As of March 31, 2015, we had the following outstanding commodity derivative instruments that were entered into for trading purposes. The information presents the notional volume of outstanding contracts by type of instrument and year of maturity (volumes represent thousands of barrels, except those identified as natural gas contracts that are presented in billions of British thermal units).

	Notional Contract Volumes by Year of Maturity	
Derivative Instrument	2015	2016
Crude oil and refined products:		
Swaps – long	3,448	—
Swaps – short	3,448	—
Futures – long	113,258	14,657
Futures – short	113,341	14,657
Options – long	3,650	—
Options – short	4,050	—
Natural gas:		
Futures – long	2,500	—
Futures – short	500	—

Interest Rate Risk

Our primary market risk exposure for changes in interest rates relates to our debt obligations. We manage our exposure to changing interest rates through the use of a combination of fixed-rate and floating-rate debt. In addition, at times we have used interest rate swap agreements to manage our fixed to floating interest rate position by converting certain fixed-rate debt to floating-rate debt. We had no interest rate derivative instruments outstanding as of March 31, 2015 or December 31, 2014, or during the three months ended March 31, 2015 and 2014.

Foreign Currency Risk

We are exposed to exchange rate fluctuations on transactions entered into by our international operations that are denominated in currencies other than the local (functional) currencies of those operations. To manage our exposure to these exchange rate fluctuations, we use foreign currency exchange and purchase contracts. These contracts are not designated as hedging instruments for accounting purposes, and therefore they are classified as economic hedges. As of March 31, 2015, we had commitments to purchase $470 million of U.S. dollars. These commitments matured before April 30, 2015.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Environmental Compliance Program Price Risk
We are exposed to market risk related to the volatility in the price of credits needed to comply with various governmental and regulatory environmental compliance programs.

Certain of these programs require us to blend biofuels into the products we produce, and we are subject to such programs in most of the countries in which we operate. These countries set annual quotas for the percentage of biofuels that must be blended into the motor fuels consumed in these countries. As a producer of motor fuels from petroleum, we are obligated to blend biofuels into the products we produce at a rate that is at least equal to the applicable quota. To the degree we are unable to blend at the applicable rate, we must purchase biofuel credits (primarily RINs in the U.S.). We are exposed to the volatility in the market price of these credits, and we manage that risk by purchasing biofuel credits when prices are deemed favorable. The cost of meeting our obligations under these biofuel programs was $133 million and $92 million for the three months ended March 31, 2015 and 2014, respectively. These amounts are reflected in cost of sales.

Effective January 1, 2015, we became subject to additional requirements under greenhouse gas emission programs, including the cap-and-trade systems, as discussed in Note 11. Under these cap-and-trade systems, we purchase various greenhouse gas emission credits available on the open market. Therefore, we are exposed to the volatility in the market price of these credits. The cost to implement certain provisions of the cap-and-trade systems are significant; however, we have recovered the majority of these costs from our customers for the three months ended March 31, 2015 and expect to continue to recover the majority of these costs in the future. For the three months ended March 31, 2015 and 2014, the net cost of meeting our obligations under these compliance programs was immaterial.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair Values of Derivative Instruments
The following tables provide information about the fair values of our derivative instruments as of March 31, 2015 and December 31, 2014 (in millions) and the line items in the balance sheets in which the fair values are reflected. See Note 11 for additional information related to the fair values of our derivative instruments.

As indicated in Note 11, we net fair value amounts recognized for multiple similar derivative contracts executed with the same counterparty under master netting arrangements, including cash collateral assets and obligations. The tables below, however, are presented on a gross asset and gross liability basis, which results in the reflection of certain assets in liability accounts and certain liabilities in asset accounts.

	Balance Sheet Location	March 31, 2015	
		Asset Derivatives	Liability Derivatives
Derivatives not designated as hedging instruments			
Commodity contracts:			
Futures	Receivables, net	$2,438	$2,455
Swaps	Receivables, net	29	33
Options	Receivables, net	1	1
Physical purchase contracts	Inventories	—	4
Foreign currency contracts	Receivables, net	3	—
Total		$2,471	$2,493

	Balance Sheet Location	December 31, 2014	
		Asset Derivatives	Liability Derivatives
Derivatives not designated as hedging instruments			
Commodity contracts:			
Futures	Receivables, net	$3,096	$2,886
Swaps	Receivables, net	34	31
Options	Receivables, net	2	3
Physical purchase contracts	Inventories	1	5
Total		$3,133	$2,925

Market and Counterparty Risk
Our price risk management activities involve the receipt or payment of fixed price commitments into the future. These transactions give rise to market risk, which is the risk that future changes in market conditions may make an instrument less valuable. We closely monitor and manage our exposure to market risk on a daily basis in accordance with policies approved by our board of directors. Market risks are monitored by a risk control group to ensure compliance with our stated risk management policy. We do not require any collateral or other security to support derivative instruments into which we enter. We also do not have any derivative instruments that require us to maintain a minimum investment-grade credit rating.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Effect of Derivative Instruments on Income and Other Comprehensive Income

The following tables provide information about the gain or loss recognized in income and other comprehensive income (OCI) on our derivative instruments and the line items in the financial statements in which such gains and losses are reflected (in millions).

Derivatives in Fair Value Hedging Relationships	Location of Gain (Loss) Recognized in Income on Derivatives	Three Months Ended March 31, 2015	2014
Commodity contracts:			
Loss recognized in income on derivatives	Cost of sales	$—	$(31)
Gain recognized in income on hedged item	Cost of sales	—	30
Loss recognized in income on derivatives (ineffective portion)	Cost of sales	—	(1)

For fair value hedges, no component of the derivative instruments' gains or losses was excluded from the assessment of hedge effectiveness for the three months ended March 31, 2015 and 2014. There were no amounts recognized in income for hedged firm commitments that no longer qualified as fair value hedges during the three months ended March 31, 2015 and 2014.

Derivatives in Cash Flow Hedging Relationships	Location of Gain (Loss) Recognized in Income on Derivatives	Three Months Ended March 31, 2015	2014
Commodity contracts:			
Gain recognized in OCI on derivatives (effective portion)		$—	$7
Gain reclassified from accumulated OCI into income (effective portion)	Cost of sales	—	3
Loss recognized in income on derivatives (ineffective portion)	Cost of sales	—	(4)

For cash flow hedges, no component of the derivative instruments' gains or losses was excluded from the assessment of hedge effectiveness for the three months ended March 31, 2014. For the three months ended March 31, 2015, there were no cumulative after-tax gains or losses on cash flow hedges remaining in accumulated other comprehensive income. For the three months ended March 31, 2015 and 2014, there were no amounts reclassified from accumulated other comprehensive income into income as a result of the discontinuance of cash flow hedge accounting.

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VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Derivatives Designated as Economic Hedges and Other Derivative Instruments	Location of Gain Recognized in Income on Derivatives	Three Months Ended March 31, 2015	2014
Commodity contracts	Cost of sales	$64	$4
Foreign currency contracts	Cost of sales	22	9

Trading Derivatives	Location of Gain (Loss) Recognized in Income on Derivatives	Three Months Ended March 31, 2015	2014
Commodity contracts	Cost of sales	$20	$(1)

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

CAUTIONARY STATEMENT FOR THE PURPOSE OF SAFE HARBOR PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Form 10-Q, including without limitation our discussion below under the heading "OVERVIEW AND OUTLOOK," includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. You can identify our forward-looking statements by the words "anticipate," "believe," "expect," "plan," "intend," "estimate," "project," "projection," "predict," "budget," "forecast," " "target," "could," "should," "may," and similar expressions.

These forward-looking statements include, among other things, statements regarding:

- future refining margins, including gasoline and distillate margins;
- future ethanol margins;
- expectations regarding feedstock costs, including crude oil differentials, and operating expenses;
- anticipated levels of crude oil and refined product inventories;
- our anticipated level of capital investments, including deferred refinery turnaround and catalyst costs and capital expenditures for environmental and other purposes, and the effect of those capital investments on our results of operations;
- anticipated trends in the supply of and demand for crude oil and other feedstocks and refined products in the regions where we operate, as well as globally;
- expectations regarding environmental, tax, and other regulatory initiatives; and
- the effect of general economic and other conditions on refining and ethanol industry fundamentals.

We based our forward-looking statements on our current expectations, estimates, and projections about ourselves and our industry. We caution that these statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that we cannot predict. In addition, we based many of these forward-looking statements on assumptions about future events that may prove to be inaccurate. Accordingly, our actual results may differ materially from the future performance that we have expressed or forecast in the forward-looking statements. Differences between actual results and any future performance suggested in these forward-looking statements could result from a variety of factors, including the following:

- acts of terrorism aimed at either our facilities or other facilities that could impair our ability to produce or transport refined products or receive feedstocks;
- political and economic conditions in nations that produce crude oil or consume refined products;
- demand for, and supplies of, refined products such as gasoline, diesel fuel, jet fuel, petrochemicals, and ethanol;
- demand for, and supplies of, crude oil and other feedstocks;
- the ability of the members of the Organization of Petroleum Exporting Countries to agree on and to maintain crude oil price and production controls;
- the level of consumer demand, including seasonal fluctuations;
- refinery overcapacity or undercapacity;
- our ability to successfully integrate any acquired businesses into our operations;
- the actions taken by competitors, including both pricing and adjustments to refining capacity in response to market conditions;
- the level of competitors' imports into markets that we supply;

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- accidents, unscheduled shutdowns, or other catastrophes affecting our refineries, machinery, pipelines, equipment, and information systems, or those of our suppliers or customers;
- changes in the cost or availability of transportation for feedstocks and refined products;
- the price, availability, and acceptance of alternative fuels and alternative-fuel vehicles;
- the levels of government subsidies for alternative fuels;
- the volatility in the market price of biofuel credits (primarily Renewable Identification Numbers (RINs) needed to comply with the United States (U.S.) federal Renewable Fuel Standard);
- delay of, cancellation of, or failure to implement planned capital projects and realize the various assumptions and benefits projected for such projects or cost overruns in constructing such planned capital projects;
- earthquakes, hurricanes, tornadoes, and irregular weather, which can unforeseeably affect the price or availability of natural gas, crude oil, grain and other feedstocks, and refined products and ethanol;
- rulings, judgments, or settlements in litigation or other legal or regulatory matters, including unexpected environmental remediation costs, in excess of any reserves or insurance coverage;
- legislative or regulatory action, including the introduction or enactment of legislation or rulemakings by governmental authorities, including tax and environmental regulations, such as those implemented under the California Global Warming Solutions Act (also known as AB 32), Quebec's Regulation respecting the cap-and-trade system for greenhouse gas emission allowances (the Quebec cap-and-trade system), and the U.S. Environmental Protection Agency's (EPA) regulation of greenhouse gases, which may adversely affect our business or operations;
- changes in the credit ratings assigned to our debt securities and trade credit;
- changes in currency exchange rates, including the value of the Canadian dollar, the pound sterling, and the euro relative to the U.S. dollar;
- overall economic conditions, including the stability and liquidity of financial markets; and
- other factors generally described in the "Risk Factors" section included in our annual report on Form 10-K for the year ended December 31, 2014 that is incorporated by reference herein.

Any one of these factors, or a combination of these factors, could materially affect our future results of operations and whether any forward-looking statements ultimately prove to be accurate. Our forward-looking statements are not guarantees of future performance, and actual results and future performance may differ materially from those suggested in any forward-looking statements. We do not intend to update these statements unless we are required by the securities laws to do so.

All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing. We undertake no obligation to publicly release any revisions to any such forward-looking statements that may be made to reflect events or circumstances after the date of this report or to reflect the occurrence of unanticipated events.

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OVERVIEW AND OUTLOOK

Overview

For the first quarter of 2015, we reported net income attributable to Valero stockholders from continuing operations of $964 million, or $1.87 per share (assuming dilution), compared to $829 million, or $1.54 per share (assuming dilution), for the first quarter of 2014. The increase of $135 million was due primarily to the increase of $144 million in our operating income as shown in the table below (in millions).

	Three Months Ended March 31,		
	2015	2014	Change
Operating income (loss) by business segment:			
Refining	$1,641	$1,280	$361
Ethanol	12	243	(231)
Corporate	(158)	(172)	14
Total	$1,495	$1,351	$144

The $361 million increase in refining segment operating income in the first quarter of 2015 compared to the first quarter of 2014 was due to higher margins on gasoline and other refined products (e.g., petroleum coke and sulfur) relative to Brent crude oil, partially offset by lower discounts for most sweet and sour crude oils relative to Brent crude oil. In addition, lower natural gas costs in the first quarter of 2015 favorably impacted our refining segment operating income compared to the first quarter of 2014. Our ethanol segment operating income decreased $231 million in the first quarter of 2015 compared to the first quarter of 2014 due to significantly lower ethanol margins that resulted from lower ethanol prices (which were impacted by lower gasoline prices) and lower co-product prices. Corn feedstock costs declined in the first quarter of 2015 compared to the first quarter of 2014, but the decline was not as significant as the decline in ethanol prices, which resulted in lower ethanol margins.

In March 2015, we issued $600 million of 3.65 percent senior notes due March 15, 2025 and $650 million of 4.9 percent senior notes due March 15, 2045, and our consolidated subsidiary, Valero Energy Partners LP, borrowed $200 million under its revolving credit facility, (the VLP Revolver), as further described in Note 4 of Condensed Notes to Consolidated Financial Statements.

Additional details and analysis of the changes in the operating income of our business segments and other components of net income attributable to Valero stockholders are provided below under “RESULTS OF OPERATIONS.”

Outlook

Energy markets and margins were volatile during the first quarter of 2015, and we expect them to continue to be volatile in the near to mid-term. Below is a summary of factors that have impacted or may impact our results of operations during the second quarter of 2015:

- Refining margins are expected to improve slightly in the second quarter, particularly gasoline margins, partially offset by narrower crude oil discounts.
- Ethanol margins are expected to remain relatively depressed as long as gasoline prices remain low.
- The market price of biofuel credits (primarily RINs) is expected to remain volatile during 2015.
- A further decline in market prices of crude oil and refined products may negatively impact the carrying value of our inventories.

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RESULTS OF OPERATIONS

The following tables highlight our results of operations, our operating performance, and market prices that directly impact our operations. The narrative following these tables provides an analysis of our results of operations.

Financial Highlights
(millions of dollars, except per share amounts)

	Three Months Ended March 31,		
	2015	2014 (a)	Change
Operating revenues	$21,330	$33,663	$(12,333)
Costs and expenses:			
Cost of sales	18,163	30,630	(12,467)
Operating expenses:			
Refining	964	972	(8)
Ethanol	120	129	(9)
General and administrative expenses	147	160	(13)
Depreciation and amortization expense:			
Refining	417	397	20
Ethanol	13	12	1
Corporate	11	12	(1)
Total costs and expenses	19,835	32,312	(12,477)
Operating income	1,495	1,351	144
Other income, net	24	15	9
Interest and debt expense, net of capitalized interest	(101)	(100)	(1)
Income from continuing operations before income tax expense	1,418	1,266	152
Income tax expense	450	429	21
Income from continuing operations	968	837	131
Loss from discontinued operations	—	(1)	1
Net income	968	836	132
Less: Net income attributable to noncontrolling interests	4	8	(4)
Net income attributable to Valero Energy Corporation stockholders	$964	$828	$136
Net income attributable to Valero Energy Corporation stockholders:			
Continuing operations	$964	$829	$135
Discontinued operations	—	(1)	1
Total	$964	$828	$136
Earnings per common share – assuming dilution:			
Continuing operations	$1.87	$1.54	$0.33
Discontinued operations	—	—	—
Total	$1.87	$1.54	$0.33

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See note references on page 37.

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Refining Operating Highlights
(millions of dollars, except per barrel amounts)

	Three Months Ended March 31,		
	2015	2014 (a)	Change
Refining:			
Operating income	$1,641	$1,280	$361
Throughput margin per barrel (b)	$12.39	$10.90	$1.49
Operating costs per barrel:			
Operating expenses	3.95	3.99	(0.04)
Depreciation and amortization expense	1.71	1.64	0.07
Total operating costs per barrel	5.66	5.63	0.03
Operating income per barrel	$6.73	$5.27	$1.46
Throughput volumes (thousand barrels per day):			
Feedstocks:			
Heavy sour crude oil	430	478	(48)
Medium/light sour crude oil	377	510	(133)
Sweet crude oil	1,145	1,063	82
Residuals	257	203	54
Other feedstocks	176	128	48
Total feedstocks	2,385	2,382	3
Blendstocks and other	325	319	6
Total throughput volumes	2,710	2,701	9
Yields (thousand barrels per day):			
Gasolines and blendstocks	1,316	1,296	20
Distillates	1,027	1,024	3
Other products (c)	406	415	(9)
Total yields	2,749	2,735	14

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See note references on page 37.

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Refining Operating Highlights by Region (d)
(millions of dollars, except per barrel amounts)

	Three Months Ended March 31,		
	2015	2014	Change
U.S. Gulf Coast: (a)			
Operating income	$872	$883	$(11)
Throughput volumes (thousand barrels per day)	1,527	1,584	(57)
Throughput margin per barrel (b)	$11.98	$11.47	$0.51
Operating costs per barrel:			
Operating expenses	3.83	3.61	