VALERO ENERGY CORP/TX
Form 10-Q
November 06, 2018

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 September 30, 2018
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 every Interactive Data File required to be submitted 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 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, a smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.
Large accelerated filer þ Accelerated filer o Non-accelerated filer o
Smaller reporting company o Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. 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 October 31, 2018 was 424,308,242.

VALERO ENERGY CORPORATION
TABLE OF CONTENTS

	Page
PART I – FINANCIAL INFORMATION	
ITEM 1. FINANCIAL STATEMENTS	
Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017	1
Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2018 and 2017	2
Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2018 and 2017	3
Consolidated Statements of Equity for the Three and Nine Months Ended September 30, 2018 and 2017	4
Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2018 and 2017	6
Condensed Notes to Consolidated Financial Statements	7
ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	38
ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	71
ITEM 4. CONTROLS AND PROCEDURES	73
PART II – OTHER INFORMATION	
ITEM 1. LEGAL PROCEEDINGS	74
ITEM 1A. RISK FACTORS	75
ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	75
ITEM 6. EXHIBITS	76
SIGNATURE	77

Table of Contents

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

VALERO ENERGY CORPORATION
CONSOLIDATED BALANCE SHEETS
(millions of dollars, except par value)

	September 30, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,551	$ 5,850
Receivables, net	8,249	6,922
Inventories	7,501	6,384
Prepaid expenses and other	590	156
Total current assets	19,891	19,312
Property, plant, and equipment, at cost	41,841	40,010
Accumulated depreciation	(13,413)	(12,530)
Property, plant, and equipment, net	28,428	27,480
Deferred charges and other assets, net	3,575	3,366
Total assets	$ 51,894	$ 50,158
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of debt and capital lease obligations	$ 199	$ 122
Accounts payable	10,224	8,348
Accrued expenses	553	712
Taxes other than income taxes payable	1,275	1,321
Income taxes payable	231	568
Total current liabilities	12,482	11,071
Debt and capital lease obligations, less current portion	8,877	8,750
Deferred income tax liabilities	4,725	4,708
Other long-term liabilities	2,850	2,729
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	7,042	7,039
Treasury stock, at cost; 248,855,313 and 239,603,534 common shares	(14,334)	(13,315)
Retained earnings	30,430	29,200
Accumulated other comprehensive loss	(1,235)	(940)
Total Valero Energy Corporation stockholders' equity	21,910	21,991
Noncontrolling interests	1,050	909
Total equity	22,960	22,900
Total liabilities and equity	$ 51,894	$ 50,158

See Condensed Notes to Consolidated Financial Statements.

1

Table of Contents

VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF INCOME
(millions of dollars, except per share amounts)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues (a)	$30,849	$23,562	$88,303	$67,588
Cost of sales:				
Cost of materials and other	27,701	20,329	79,317	59,366
Operating expenses (excluding depreciation and amortization expense reflected below)	1,193	1,135	3,439	3,370
Depreciation and amortization expense	504	484	1,499	1,457
Total cost of sales	29,398	21,948	84,255	64,193
Other operating expenses	10	44	41	44
General and administrative expenses (excluding depreciation and amortization expense reflected below)	209	225	695	592
Depreciation and amortization expense	13	13	39	39
Operating income	1,219	1,332	3,273	2,720
Other income, net	42	23	88	76
Interest and debt expense, net of capitalized interest	(111)	(114)	(356)	(354)
Income before income tax expense	1,150	1,241	3,005	2,442
Income tax expense	276	378	674	686
Net income	874	863	2,331	1,756
Less: Net income attributable to noncontrolling interests	18	22	161	62
Net income attributable to Valero Energy Corporation stockholders	$856	$841	$2,170	$1,694
Earnings per common share	$2.01	$1.91	$5.05	$3.80
Weighted-average common shares outstanding (in millions)	425	439	428	444
Earnings per common share – assuming dilution	$2.01	$1.91	$5.05	$3.80
Weighted-average common shares outstanding – assuming dilution (in millions)	427	441	430	446

Supplemental information:

(a) Includes excise taxes on sales by certain of our international operations	$1,338	$1,447	$4,272	$4,103

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(millions of dollars)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$874	$863	$2,331	$1,756
Other comprehensive income (loss):				
Foreign currency translation adjustment	23	228	(223)	510
Net gain on pension and other postretirement benefits	8	4	25	11
Other comprehensive income (loss) before income tax expense	31	232	(198)	521
Income tax expense related to items of other comprehensive income (loss)	1	1	5	3
Other comprehensive income (loss)	30	231	(203)	518
Comprehensive income	904	1,094	2,128	2,274
Less: Comprehensive income attributable to noncontrolling interests	21	23	162	63
Comprehensive income attributable to Valero Energy Corporation stockholders	$883	$1,071	$1,966	$2,211

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(millions of dollars)
(unaudited)

	Valero Energy Corporation Stockholders' Equity							
	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total	Non-controlling Interests	Total Equity
Balance as of June 30, 2018	$7	$ 7,032	$(13,923)	$29,915	$ (1,262)	$21,769	$ 1,035	$22,804
Net income	—	—	—	856	—	856	18	874
Dividends on common stock ($0.80 per share)	—	—	—	(341)	—	(341)	—	(341)
Stock-based compensation expense	—	11	—	—	—	11	—	11
Transactions in connection with stock-based compensation plans	—	—	(15)	—	—	(15)	—	(15)
Stock purchases under purchase programs	—	—	(396)	—	—	(396)	—	(396)
Distributions to noncontrolling interests	—	—	—	—	—	—	(13)	(13)
Other	—	(1)	—	—	—	(1)	7	6
Other comprehensive income	—	—	—	—	27	27	3	30
Balance as of September 30, 2018	$7	$ 7,042	$(14,334)	$30,430	$ (1,235)	$21,910	$ 1,050	$22,960
Balance as of June 30, 2017	$7	$ 7,096	$(12,660)	$26,603	$ (1,123)	$19,923	$ 842	$20,765
Net income	—	—	—	841	—	841	22	863
Dividends on common stock ($0.70 per share)	—	—	—	(309)	—	(309)	—	(309)
Stock-based compensation expense	—	12	—	—	—	12	—	12
Transactions in connection with stock-based compensation plans	—	(7)	(3)	—	—	(10)	—	(10)
Stock purchases under purchase program	—	—	(276)	—	—	(276)	—	(276)
Distributions to noncontrolling interests	—	—	—	—	—	—	(11)	(11)
Other	—	(41)	—	—	—	(41)	—	(41)
Other comprehensive income	—	—	—	—	230	230	1	231
Balance as of September 30, 2017	$7	$ 7,060	$(12,939)	$27,135	$ (893)	$20,370	$ 854	$21,224

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY (Continued)
(millions of dollars)
(unaudited)

	Valero Energy Corporation Stockholders' Equity							
	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total	Non-controlling Interests	Total Equity
Balance as of December 31, 2017	$7	$ 7,039	$(13,315)	$29,200	$ (940)	$21,991	$ 909	$22,900
Reclassification of stranded income tax effects of Tax Reform per ASU 2018-02 (see Note 1)	—	—	—	91	(91)	—	—	—
Net income	—	—	—	2,170	—	2,170	161	2,331
Dividends on common stock ($2.40 per share)	—	—	—	(1,031)	—	(1,031)	—	(1,031)
Stock-based compensation expense	—	40	—	—	—	40	—	40
Transactions in connection with stock-based compensation plans	—	(34)	(115)	—	—	(149)	—	(149)
Stock purchases under purchase programs	—	—	(904)	—	—	(904)	—	(904)
Contributions from noncontrolling interests	—	—	—	—	—	—	32	32
Distributions to noncontrolling interests	—	—	—	—	—	—	(63)	(63)
Other	—	(3)	—	—	—	(3)	10	7
Other comprehensive income (loss)	—	—	—	—	(204)	(204)	1	(203)
Balance as of September 30, 2018	$7	$ 7,042	$(14,334)	$30,430	$ (1,235)	$21,910	$ 1,050	$22,960
Balance as of December 31, 2016	$7	$ 7,088	$(12,027)	$26,366	$ (1,410)	$20,024	$ 830	$20,854
Net income	—	—	—	1,694	—	1,694	62	1,756
Dividends on common stock ($2.10 per share)	—	—	—	(936)	—	(936)	—	(936)
Stock-based compensation expense	—	37	—	—	—	37	—	37
Transactions in connection with stock-based compensation plans	—	(34)	13	—	—	(21)	—	(21)
Stock purchases under purchase programs	—	—	(925)	—	—	(925)	—	(925)
Issuance of Valero Energy Partners LP common units	—	—	—	—	—	—	33	33
Distributions to noncontrolling interests	—	—	—	—	—	—	(56)	(56)
Other	—	(31)	—	11	—	(20)	(16)	(36)
Other comprehensive income	—	—	—	—	517	517	1	518
Balance as of September 30, 2017	$7	$ 7,060	$(12,939)	$27,135	$ (893)	$20,370	$ 854	$21,224

See Condensed Notes to Consolidated Financial Statements.

Table of Contents

VALERO ENERGY CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(millions of dollars)
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
Cash flows from operating activities:		
Net income	$2,331	$1,756
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	1,538	1,496
Deferred income tax expense (benefit)	(62)	80
Changes in current assets and current liabilities	(1,174)	544
Changes in deferred charges and credits and other operating activities, net	60	(54)
Net cash provided by operating activities	2,693	3,822
Cash flows from investing activities:		
Capital expenditures	(1,168)	(913)
Deferred turnaround and catalyst costs	(661)	(381)
Investments in joint ventures	(124)	(373)
Capital expenditures of certain variable interest entities	(89)	—
Peru Acquisition, net of cash acquired	(466)	—
Acquisitions of undivided interests	(181)	(72)
Minor acquisitions	(88)	—
Other investing activities, net	9	(1)
Net cash used in investing activities	(2,768)	(1,740)
Cash flows from financing activities:		
Proceeds from debt issuances and borrowings	1,329	—
Repayments of debt and capital lease obligations	(1,352)	(15)
Purchase of common stock for treasury	(1,081)	(951)
Common stock dividends	(1,031)	(936)
Proceeds from issuance of Valero Energy Partners LP common units	—	36
Contributions from noncontrolling interests	32	—
Distributions to noncontrolling interests	(63)	(56)
Other financing activities, net	(15)	(21)
Net cash used in financing activities	(2,181)	(1,943)
Effect of foreign exchange rate changes on cash	(43)	221
Net increase (decrease) in cash and cash equivalents	(2,299)	360
Cash and cash equivalents at beginning of period	5,850	4,816
Cash and cash equivalents at end of period	$3,551	$5,176

See Condensed Notes to Consolidated Financial Statements.

VALERO ENERGY CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

General
As used in this report, the terms “Valero,” “we,” “us,” or “our” 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. Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

The balance sheet as of December 31, 2017 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, 2017.

Reclassifications
Certain prior period amounts have been reclassified to conform to the 2018 presentation.

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.

Revenue Recognition
Background
We adopted the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification Topic 606, “Revenue from Contracts with Customers,” (Topic 606) on January 1, 2018, as described below in “Accounting Pronouncements Adopted on January 1, 2018.” Accordingly, our revenue recognition accounting policy has been revised to reflect the adoption of this standard.

Revised Policy
Our revenues are primarily generated from contracts with customers. We generate revenue from contracts with customers from the sale of products by our refining and ethanol segments. Our VLP segment generates intersegment revenues from transportation and terminaling activities provided to our refining segment that are eliminated in consolidation. Revenues are recognized when we satisfy our performance obligation to transfer products to our customers, which typically occurs at a point in time upon shipment or delivery of the products, and for an amount that reflects the transaction price that is allocated to the performance obligation.

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

The customer is able to direct the use of, and obtain substantially all of the benefits from, the products at the point of shipment or delivery. As a result, we consider control to have transferred upon shipment or delivery because we have a present right to payment at that time, the customer has legal title to the asset, we have transferred physical possession of the asset, and the customer has significant risks and rewards of ownership of the asset.

Our contracts with customers state the final terms of the sale, including the description, quantity, and price for goods sold. Payment is typically due in full within two to ten days of delivery. In the normal course of business, we generally do not accept product returns.

The transaction price is the consideration that we expect to be entitled to in exchange for our products. The transaction price for substantially all of our contracts is generally based on commodity market pricing (i.e., variable consideration). As such, this market pricing may be constrained (i.e., not estimable) at the inception of the contract but will be recognized based on the applicable market pricing, which will be known upon transfer of the goods to the customer. Some of our contracts also contain variable consideration in the form of sales incentives to our customers, such as discounts and rebates. For contracts that include variable consideration, we estimate the factors that determine the variable consideration in order to establish the transaction price.

We have elected to exclude from the measurement of the transaction price all taxes assessed by governmental authorities that are both imposed on and concurrent with a specific revenue-producing transaction and collected by us from a customer (e.g., sales tax, use tax, value-added tax, etc.). We continue to include in the transaction price excise taxes that are imposed on certain inventories in our international operations. The amount of such taxes is provided in supplemental information in a footnote on the statements of income.

There are instances where we provide shipping services in relation to the goods sold to our customer. Shipping and handling costs that occur before the customer obtains control of the goods are deemed to be fulfillment activities and are included in cost of materials and other. We have elected to account for shipping and handling activities that occur after the customer has obtained control of a good as fulfillment activities rather than as a promised service and we have included these activities in cost of materials and other.

Accounting Pronouncements Adopted During 2018
Topic 606
As previously noted, we adopted the provisions of Topic 606 on January 1, 2018. Topic 606 clarifies the principles for recognizing revenue and supersedes previous revenue recognition requirements under “Revenue Recognition (Topic 605),” using the modified retrospective method of adoption as permitted by the standard. Under this method, the cumulative effect of initially applying the standard is recognized as an adjustment to the opening balance of retained earnings, and revenues reported in the periods prior to the date of adoption are not changed. We elected to apply the transition guidance for Topic 606 only to contracts that were not completed as of the date of adoption. There was no material impact to our financial position as a result of adopting Topic 606; therefore, there was no cumulative-effect adjustment to retained earnings as of January 1, 2018. Additionally, there was no material impact to our financial position or results of operations as of and for the three and nine months ended September 30, 2018. See “Revenue Recognition” above for a discussion of our accounting policy affected by our adoption of Topic 606. Also see Note 12 for further

8

Table of Contents

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

information on our revenues. We implemented new processes in order to monitor ongoing compliance with accounting and disclosure requirements.

ASU No. 2016-01

In January 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," (ASU No. 2016-01) to enhance the reporting model for financial instruments regarding certain aspects of recognition, measurement, presentation, and disclosure. We adopted the provisions of ASU No. 2016-01 on January 1, 2018 using the cumulative-effect method of adoption as required by the ASU. The adoption of this ASU did not affect our financial position or our results of operations as of or for the three and nine months ended September 30, 2018, but it resulted in reduced disclosures as it eliminated the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments.

ASU No. 2017-04

In January 2017, the FASB issued ASU No. 2017-04, "Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment," (ASU No. 2017-04) to simplify the subsequent measurement of goodwill by eliminating Step 2 from the goodwill impairment test. Under the provisions of this ASU, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, including goodwill (rather than under the current method of comparing the implied fair value of goodwill with its carrying amount), and should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. However, the impairment charge should not exceed the carrying amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The provisions of ASU No. 2017-04 are effective for annual or any interim goodwill impairment tests in reporting periods beginning after December 15, 2019 on a prospective basis, with early adoption permitted. We adopted the provisions of ASU No. 2017-04 on October 1, 2018. The adoption of this ASU will not have an immediate effect on our financial position or results of operations, but may result in additional disclosures, as it is applied prospectively to impairment tests performed after the date of adoption.

ASU No. 2017-07

In March 2017, the FASB issued ASU No. 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," (ASU No. 2017-07) that requires employers to report the service cost component of net periodic pension cost and net periodic postretirement benefit cost in the same line item as other compensation costs arising from services rendered by the pertinent employees during the period. It also requires the other components of net periodic pension cost and net periodic postretirement benefit cost (non-service cost components) to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations. We retrospectively adopted the provisions of ASU No. 2017-07 on January 1, 2018. The adoption of this ASU did not affect our financial position or results of operations, but did result in the reclassification of non-service cost components from operating expenses (excluding depreciation and amortization expense) and general and administrative expenses (excluding depreciation and amortization expense) to other income, net. This resulted in an increase of $10 million and $31 million in operating expenses (excluding depreciation and amortization expense) and a decrease of $4 million and

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

$5 million in general and administrative expenses (excluding depreciation and amortization expense) for the three and nine months ended September 30, 2017, respectively.

ASU No. 2017-09
In May 2017, the FASB issued ASU No. 2017-09, "Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting," (ASU No. 2017-09) to reduce diversity in practice, as well as reduce cost and complexity regarding a change to the terms or conditions of a share-based payment award. We adopted ASU No. 2017-09 on January 1, 2018. The adoption of this ASU did not have an immediate effect on our financial position or results of operations as it is applied prospectively to an award modified on or after adoption.

ASU No. 2018-02
In February 2018, the FASB issued ASU No. 2018-02, "Income Statement—Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income," (ASU No. 2018-02) that allows for the stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 (Tax Reform) to be reclassified from accumulated other comprehensive income to retained earnings. The provisions of ASU No. 2018-02 are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within those annual reporting periods, with early adoption permitted. This ASU shall be applied either at the beginning of the annual or interim period of adoption or retrospectively to each period in which the income tax effects of Tax Reform affects the items remaining in accumulated other comprehensive income. We adopted ASU No. 2018-02 on January 1, 2018 and elected to reclassify the stranded income tax effects of Tax Reform from accumulated other comprehensive loss to retained earnings as of the beginning of the interim period of adoption. The adoption of this ASU did not affect our financial position or results of operations but resulted in the reclassification of $91 million of income tax benefits related to Tax Reform from accumulated other comprehensive loss to retained earnings as presented in our statement of equity and in Note 7 under "Accumulated Other Comprehensive Loss." We release stranded income tax effects from accumulated other comprehensive loss to retained earnings on an individual item basis as those items are reclassified into income.

ASU No. 2018-05
In March 2018, the FASB issued ASU No. 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118," (ASU No. 2018-05) to amend certain Securities and Exchange Commission (SEC) material in Topic 740 for the income tax accounting implications of the recently issued Tax Reform. This guidance clarifies the application of Topic 740 in situations where a registrant does not have the necessary information available, prepared, or analyzed in reasonable detail to complete the accounting under Topic 740 for certain income tax effects of Tax Reform for the reporting period in which Tax Reform was enacted. See Note 10 for a discussion of the impact of this ASU.

ASU No. 2018-13
In August 2018, the FASB issued ASU No. 2018-13, "Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirements for Fair Value Measurement," (ASU No. 2018-13) to improve the effectiveness of disclosures in the notes to financial statements by removing, modifying, and adding certain disclosure requirements for fair value measurements. For example, entities will no longer be required to disclose the amount of and reasons for transfers between Level 1 and Level 2 of the fair value hierarchy, but will be required to disclose the range and weighted average of significant unobservable inputs used to develop Level 3 fair value measurements. The provisions of ASU No. 2018-13 are effective for all

Table of Contents

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

entities for annual reporting periods, beginning after December 15, 2019, and interim periods within those annual reporting periods, with early adoption permitted. Certain provisions of this ASU, primarily related to disclosures, require the prospective method of adoption, with the remaining provisions applied retrospectively. We adopted all of the provisions of ASU No. 2018-13 on October 1, 2018. The adoption of this ASU will not affect our financial position or results of operations, but will result in revised disclosures.

Accounting Pronouncements Not Yet Adopted
Topic 842
In February 2016, the FASB issued "Leases (Topic 842)," (Topic 842) to increase the transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. This new standard is effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within those annual reporting periods, with early adoption permitted. We will adopt this new standard on January 1, 2019, and we expect to use the optional transition method, which allows us to recognize a cumulative-effect adjustment to the opening balance of retained earnings at the date of adoption and apply the new disclosure requirements beginning in the period of adoption.

The new standard provides a number of optional practical expedients and we expect to elect the following:

- Transition Elections. We expect to elect the package of practical expedients that permits us to not reassess under the new standard our prior conclusions about lease identification, lease classification, and initial direct costs, as well as the practical expedient that permits us to not assess existing land easements under the new standard.

- Ongoing Accounting Policy Elections. We expect to elect the short-term lease recognition exemption whereby right-of-use (ROU) assets and lease liabilities will not be recognized for leasing arrangements with terms less than one year, and the practical expedient to not separate lease and non-lease components for all classes of underlying assets other than the marine transportation asset class.

We are enhancing our contracting and lease evaluation systems and related processes, and we are developing a new lease accounting system to capture our leases and support the required disclosures. We have monitored and will continue to monitor the adoption process to ensure compliance with accounting and disclosure requirements. We also continue the integration of our lease accounting system with our general ledger, including the modifications to our related procurement and payment processes during the fourth quarter of 2018.

We anticipate this standard will have a material impact on (i) the recognition of ROU assets and lease liabilities on our balance sheet for our operating leases, (ii) the derecognition of existing assets under construction in a build-to-suit lease arrangement (see Note 6 under "Commitments—MVP Terminal"), and (iii) the presentation of new disclosures about our leasing activities. However, we do not expect adoption to have a material impact on our results of operations or liquidity. We expect our accounting for capital leases to remain substantially unchanged.

Table of Contents

ASU No. 2016-13

In June 2016, the FASB issued “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments,” (ASU No. 2016-13) to improve financial reporting by requiring the immediate recognition of credit losses on financial instruments held by a reporting entity. This ASU requires the measurement of all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. It also requires enhanced disclosures, including qualitative and quantitative requirements that provide additional information about the amounts recorded in the financial statements. The provisions of this ASU are effective for annual reporting periods beginning after December 15, 2019, and interim periods within those annual reporting periods, with early adoption permitted for annual periods beginning after December 15, 2018. The provisions of this ASU should be applied through a cumulative-effect adjustment to retained earnings as of the beginning of the first reporting period in which this ASU is effective (i.e., the modified-retrospective approach). We expect to adopt ASU No. 2016-13 effective January 1, 2020 and we do not expect such adoption to affect our financial position or our results of operations.

ASU No. 2017-12

In August 2017, the FASB issued ASU No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,” (ASU No. 2017-12) to improve and simplify accounting guidance for hedge accounting. The provisions of this ASU are effective for annual reporting periods beginning after December 15, 2018, and interim reporting periods within those annual reporting periods, with early adoption permitted. We use derivative instruments to hedge our commodity price risk; however, we have not designated these derivative instruments as fair value or cash flow hedges (see Note 15). Certain provisions of this ASU, primarily related to disclosures, require the prospective method of adoption, with the remaining provisions applied through a cumulative-effect adjustment to retained earnings as of the adoption date. The adoption of ASU No. 2017-12 effective January 1, 2019 is not expected to affect our financial position or results of operations.

ASU No. 2018-14

In August 2018, the FASB issued ASU No. 2018-14, “Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans,” (ASU No. 2018-14) to improve the effectiveness of disclosures in the notes to financial statements by removing, modifying, and adding certain disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. For example, entities will no longer be required to disclose the amounts in accumulated other comprehensive income expected to be recognized as components of net periodic benefit cost over the next fiscal year, but will be required to (i) disclose the weighted-average interest crediting rates for cash balance plans and other plans with promised interest crediting rates and (ii) provide an explanation of the reasons for significant gains and losses related to changes in the benefit obligation for the period. The provisions of ASU No. 2018-14 are effective for annual reporting periods ending after December 15, 2020 on a retrospective basis for all periods presented, with early adoption permitted. We anticipate adopting ASU No. 2018-14 on December 31, 2018. The adoption of this ASU will not affect our financial position or results of operations, but will result in revised disclosures.

Table of Contents

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

ASU No. 2018-17
In October 2018, the FASB issued ASU No. 2018-17, “Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities,” (ASU No. 2018-17) to reduce the cost and complexity of financial reporting associated with consolidation of variable interest entities (VIEs). We consolidate a VIE when we have a variable interest in an entity for which we are the primary beneficiary as further described in Note 8. One of the provisions of this ASU amends how a decision maker or service provider determines whether its fee is a variable interest. This guidance requires reporting entities to consider indirect interests held through related parties under common control on a proportional basis rather than as the equivalent of a direct interest in its entirety (as currently required in GAAP). The provisions of this ASU are effective for annual reporting periods beginning after December 15, 2019, and interim reporting periods within those annual reporting periods, with early adoption permitted. The provisions should be applied on a retrospective basis with a cumulative-effect adjustment to retained earnings as of the beginning of the earliest period presented. We expect to adopt ASU No. 2018-17 effective January 1, 2019 and we do not expect such adoption to affect our financial position or results of operations, but may impact future transactions with VIEs.

2. SUBSEQUENT EVENTS

Pending Acquisition of Ethanol Plants
On October 8, 2018, we entered into an agreement to acquire three ethanol plants from two subsidiaries of Green Plains Inc. for total cash consideration of $300 million plus working capital of approximately $28 million. The ethanol plants are located in Bluffton, Indiana; Lakota, Iowa; and Riga, Michigan with a combined ethanol production capacity of 280 million gallons per year. We expect the acquisition will be completed in the fourth quarter of 2018.

Pending Merger with Valero Energy Partners LP (VLP)
On October 18, 2018, we entered into a definitive Agreement and Plan of Merger (Merger Agreement and, together with the transactions contemplated thereby, the Merger Transaction) with VLP pursuant to which we have agreed to acquire, for cash, all of the outstanding publicly held common units of VLP at a price of $42.25 per common unit, for an aggregate transaction value of approximately $950 million. The Merger Transaction is expected to close as soon as possible following the satisfaction of certain customary closing conditions. We currently consolidate the financial statements of VLP (see Note 8) and we reflect noncontrolling interests on our balance sheet for the portion of VLP’s partners’ capital held by VLP’s public common unitholders. Upon the closing of the Merger Transaction, VLP will become an indirect wholly owned subsidiary and we will no longer reflect its noncontrolling interest on our balance sheet. In addition, we will no longer attribute a portion of VLP’s net income to noncontrolling interests.

3. ACQUISITION

Peru Acquisition
On May 14, 2018, we acquired 100 percent of the issued and outstanding equity interests in Pure Biofuels del Peru S.A.C. (Pure Biofuels) from Pegasus Capital Advisors L.P. and various minority equity holders (collectively, the sellers). Pure Biofuels markets refined petroleum products through a network of logistics assets throughout Peru. Pure Biofuels owns a terminal at the Port of Callao, near Lima, with approximately 1 million barrels of storage capacity for refined petroleum and renewable products. Through one of its

subsidiaries, Pure Biofuels also owns a 180,000-barrel storage terminal in Paita, in northern Peru, which is scheduled to commence operations later in 2018. We paid $466 million from available cash on hand, of which $130 million was for working capital. The amount paid for working capital was adjusted in the third quarter of 2018 and is subject to further adjustment pending the final working capital settlement that is expected to be completed in the fourth quarter of 2018. This acquisition, which is referred to as the Peru Acquisition, is consistent with our general business strategy and broadens the geographic diversity of our refining segment.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the acquisition date, which are preliminary and subject to change after the completion of an independent appraisal that we expect to complete in the fourth quarter of 2018 (in millions).

Current assets, net of cash acquired	$156
Property, plant, and equipment	137
Deferred charges and other assets	445
Current liabilities, excluding current portion of debt	(26)
Debt assumed, including current portion	(137)
Deferred income tax liabilities	(81)
Other long-term liabilities	(22)
Noncontrolling interest	(6)
Total consideration, net of cash acquired	$466

Deferred charges and other assets primarily include identifiable intangible assets of $210 million and goodwill of $228 million. Identifiable intangible assets, which consist of customer contracts and relationships, are amortized on a straight-line basis over ten years. Goodwill is calculated as the excess of the consideration transferred over the estimated fair values of the underlying tangible and identifiable intangible assets acquired and liabilities assumed. Goodwill represents the future economic benefits expected to be recognized from our expansion into the South American refined petroleum products market arising from other assets acquired that were not individually identified and separately recognized. We determined that the entire balance of goodwill is related to the refining segment. None of the goodwill is expected to be deductible for tax purposes.

The Peru Acquisition purchase agreement provides for a potential earn-out payment based on Pure Biofuels' earnings for the period from January 1, 2021 through December 31, 2021, or if certain events occur, for the period from January 1, 2020 through December 31, 2020. The sellers are entitled to receive the contingent earn-out payments if certain financial metrics are achieved by Pure Biofuels. As of September 30, 2018, we did not record a contingent liability with respect to this earn-out agreement based on our preliminary estimate of its fair value.
Our consolidated statements of income include the results of operations of Pure Biofuels since the date of acquisition, and such results are reflected in the refining segment. Results of operations since the date of acquisition, supplemental pro forma financial information, and acquisition-related costs have not been presented for the Peru Acquisition as such information is not material to our results of operations.

Table of Contents

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

4. INVENTORIES

Inventories consisted of the following (in millions):

	September 30, 2018	December 31, 2017
Refinery feedstocks	$ 2,607	$ 2,427
Refined petroleum products and blendstocks	4,423	3,459
Ethanol feedstocks and products	211	242
Materials and supplies	260	256
Inventories	$ 7,501	$ 6,384

As of September 30, 2018 and December 31, 2017, the replacement cost (market value) of LIFO inventories exceeded their LIFO carrying amounts by $4.7 billion and $3.0 billion, respectively, and our non-LIFO inventories accounted for $1.4 billion and $1.0 billion, respectively, of our total inventories.

5. DEBT AND CAPITAL LEASE OBLIGATIONS

Debt
During the nine months ended September 30, 2018, the following activity occurred:

- We issued in a public offering $750 million aggregate principal amount of our 4.35 percent Senior Notes due June 1, 2028. Gross proceeds from this debt issuance were $749 million before deducting the underwriting discount and other debt issuance costs totaling $7 million. The proceeds were used to redeem our 9.375 percent Senior Notes due March 15, 2019 (9.375 percent Senior Notes) for $787 million, which includes an early redemption fee of $37 million that was charged to other income, net.

- VLP issued in a public offering $500 million aggregate principal amount of its 4.5 percent Senior Notes due March 15, 2028. Gross proceeds from this debt issuance were $498 million before deducting the underwriting discount and other debt issuance costs totaling $5 million. The proceeds are available only to the operations of VLP and were used to repay the outstanding balance of $410 million on VLP's $750 million senior unsecured revolving credit facility (the VLP Revolver) and $85 million of its notes payable to us, which is eliminated in consolidation.

- Central Mexico Terminals, which is the name used by us to refer to certain of our consolidated VIEs and is further described and defined in Note 8, entered into a combined $340 million unsecured revolving credit facility (IEnova Revolver) with IEnova (defined in Note 8). Central Mexico Terminals borrowed $71 million and had no repayments under the IEnova Revolver. The IEnova Revolver matures in February 2028. However, IEnova may terminate the IEnova Revolver at any time and demand repayment of all outstanding amounts; therefore, such amounts are reflected in current portion of debt. The IEnova Revolver is available only to the operations of Central Mexico Terminals, and the creditors of Central Mexico Terminals do not have recourse against Valero.

Table of Contents

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

Outstanding borrowings under the IEnova Revolver bear interest at the three-month LIBO rate for the applicable interest period in effect from time to time plus the applicable margin. The interest rate under the IEnova Revolver is subject to adjustment, with agreement by both parties, based upon changes in market conditions. As of September 30, 2018, the variable rate was 5.987 percent.

- We retired $137 million of debt assumed in connection with the Peru Acquisition with available cash on hand.

During the nine months ended September 30, 2017, we had no significant debt activity.

We had outstanding borrowings, letters of credit issued, and availability under our credit facilities as follows (amounts in millions and currency in U.S. dollars, except as noted):

	September 30, 2018				
	Facility Amount	Maturity Date	Outstanding Borrowings	Letters of Credit Issued	Availability
Committed facilities:					
Valero Revolver	$ 3,000	November 2020	$ —	$ 60	$ 2,940
VLP Revolver	$ 750	November 2020	$ —	$ —	$ 750
IEnova Revolver	$ 340	February 2028	$ 71	n/a	$ 269
Canadian Revolver (a)	C$ 75	November 2018	C$ —	C$ 5	C$ 70
Accounts receivable sales facility	$ 1,300	July 2019	$ 100	n/a	$ 1,200
Letter of credit facility (a)	$ 100	November 2018	n/a	$ —	$ 100
Uncommitted facilities:					
Letter of credit facilities	n/a	n/a	n/a	$ 307	n/a

(a) This facility is expected to be amended to extend the maturity date from November 2018 to November 2019.

Letters of credit issued as of September 30, 2018 expire at various times in 2018 through 2020.

As of September 30, 2018 and December 31, 2017, the variable interest rate on the accounts receivable sales facility was 2.7959 percent and 2.0387 percent, respectively.

Other Disclosures

Interest and debt expense, net of capitalized interest is comprised of the following (in millions):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Interest and debt expense	$ 134	$ 134	$ 417	$ 402
Less capitalized interest	23	20	61	48
Interest and debt expense, net of	$ 111	$ 114	$ 356	$ 354

capitalized interest

16

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

6. COMMITMENTS AND CONTINGENCIES

Commitments

MVP Terminal

We have a 50 percent membership interest in MVP Terminalling, LLC (MVP), a Delaware limited liability company formed in September 2017 with a subsidiary of Magellan Midstream Partners LP (Magellan), to construct, own, and operate the Magellan Valero Pasadena marine terminal (MVP Terminal) located adjacent to the Houston Ship Channel in Pasadena, Texas. Construction of phases one and two of the project began in 2017 with a total estimated cost of $840 million, of which we have committed to contribute 50 percent (approximately $420 million). The project could expand up to four phases with a total project cost of approximately $1.4 billion if warranted by additional demand and agreed to by Magellan and us. Since inception, we have contributed $188 million to MVP, of which $107 million was contributed during the nine months ended September 30, 2018.

Concurrent with the formation of MVP, we entered into a terminaling agreement with MVP to utilize the MVP Terminal upon completion of phase two, which is expected to occur in early 2020. The terminaling agreement has an initial term of 12 years with two five-year automatic renewals, and year-to-year renewals thereafter.

Due to our membership interest in MVP and because we determined that the terminaling agreement was a capital lease, we are the accounting owner of the MVP Terminal during the construction period. Accordingly, as of September 30, 2018, we recorded an asset of $442 million in property, plant, and equipment representing 100 percent of the construction costs incurred by MVP, as well as capitalized interest incurred by us, and a long-term liability of $254 million payable to Magellan. The amounts recorded for the portion of the construction costs associated with the payable to Magellan are noncash investing and financing items, respectively.

Central Texas Pipeline

We have committed to a 40 percent undivided interest in a project with a subsidiary of Magellan to jointly build an estimated 130-mile, 20-inch refined petroleum products pipeline with a capacity of up to 150,000 barrels per day from Houston to Hearne, Texas. The pipeline is expected to be completed in mid-2019. The estimated cost of our 40 percent undivided interest in this pipeline is $170 million. Since inception, capital expenditures have totaled $50 million, of which $43 million was spent during the nine months ended September 30, 2018.

Sunrise Pipeline System

Effective January 31, 2018, we entered into a joint ownership agreement with Sunrise Pipeline LLC, a subsidiary of Plains All American Pipeline, L.P. (Plains), that provides us a 20 percent undivided interest in the Sunrise Pipeline System expansion to be constructed by Plains. The Sunrise Pipeline System is expected to contain (i) a 262-mile, 24-inch crude oil pipeline (the Sunrise Pipeline) that originates at Plains' terminal in Midland, Texas and ends at Plains' station in Wichita Falls, Texas with throughput capacity of approximately 500,000 barrels per day, and (ii) two 270,000 shell barrel capacity tanks located at the Colorado City, Texas station. The Sunrise Pipeline System expansion is expected to be placed in service in the fourth quarter of 2018. Capital expenditures totaled $138 million for the nine months ended September 30, 2018.

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

Environmental Matters
We are involved, together with several other companies, in an environmental cleanup in the Village of Hartford, Illinois (the Village) and during 2015, one of these companies assumed the ongoing environmental cleanup in the Village pursuant to a federal court order. We had previously conducted an initial response in the Village, along with other companies, pursuant to an administrative order issued by the U.S. Environmental Protection Agency (EPA). The parties involved in the initial response may have further claims among themselves for costs already incurred.

We also continue to be engaged in site assessment and interim measures at our shutdown refinery site, which is adjacent to the Village. During the second quarter of 2018, we entered into a consent order with the Illinois EPA that was approved by the state court on July 26, 2018. In the consent order, we assumed the underlying liability for full cleanup of our shutdown refinery site, and we recorded an adjustment to our existing environmental liability related to this matter, which did not materially affect our financial position or results of operations as of or for the nine months ended September 30, 2018. We continue to seek contribution under Illinois law in state court and are pursuing claims under the Comprehensive Environmental Response, Compensation and Liability Act in federal court from other potentially responsible parties. Factors underlying the expected cost of the cleanup are subject to change from time to time, and actual results may vary significantly from the current 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.

7. EQUITY

Share Activity
There was no significant share activity during the nine months ended September 30, 2018 and 2017.

Common Stock Dividends
On October 31, 2018, our board of directors declared a quarterly cash dividend of $0.80 per common share payable on December 12, 2018 to holders of record at the close of business on November 20, 2018.

Table of Contents

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

Accumulated Other Comprehensive Loss

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

	Nine Months Ended September 30,					
	2018			2017		
	Foreign Currency Translation Adjustment	Defined Benefit Plans Items	Total	Foreign Currency Translation Adjustment	Defined Benefit Plans Items	Total
Balance as of beginning of period	$(507)	$(433)	$(940)	$(1,021)	$(389)	$(1,410)
Other comprehensive income (loss) before reclassifications	(224)	—	(224)	509	—	509
Amounts reclassified from accumulated other comprehensive loss	—	20	20	—	8	8
Other comprehensive income (loss)	(224)	20	(204)	509	8	517
Reclassification of stranded income tax effects of Tax Reform to retained earnings per ASU 2018-02 (see Note 1)	—	(91)	(91)	—	—	—
Balance as of end of period	$(731)	$(504)	$(1,235)	$(512)	$(381)	$(893)

8. VARIABLE INTEREST ENTITIES

Consolidated VIEs

We consolidate a VIE when we have a variable interest in an entity for which we are the primary beneficiary. Our significant consolidated VIE’s include:

- VLP, a publicly traded master limited partnership formed to own, operate, develop, and acquire crude oil and refined petroleum products pipelines, terminals, and other transportation and logistics assets;
- Diamond Green Diesel Holdings LLC (DGD), a joint venture formed to construct and operate a biodiesel plant that processes animal fats, used cooking oils, and other vegetable oils into renewable green diesel; and
- Central Mexico Terminals (previously referred to by us as VPM Terminals), a collective group of three subsidiaries of Infraestructura Energetica Nova, S.A.B. de C.V. (IEnova), a Mexican company and subsidiary of Sempra Energy, a U.S. public company. We have terminaling agreements with Central Mexico Terminals that represent variable interests. We do not have an ownership interest in Central Mexico Terminals.

The VIEs’ assets can only be used to settle their own obligations and the VIEs’ creditors have no recourse to our assets. We do not provide financial guarantees to our VIEs. Although we have provided credit facilities to some of our VIEs in support of their construction or acquisition activities, these transactions are eliminated

Table of Contents

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

in consolidation. Our financial position, results of operations, and cash flows are impacted by our consolidated VIEs' performance, net of intercompany eliminations, to the extent of our ownership interest in each VIE.

The following tables present summarized balance sheet information for the significant assets and liabilities of our VIEs, which are included in our balance sheets (in millions).

	September 30, 2018				
	VLP	DGD	Central Mexico Terminals	Other	Total
Assets					
Cash and cash equivalents	$ 128	$ 78	$ 1	$ 20	$ 227
Other current assets	1	94	17	51	163
Property, plant, and equipment, net	1,414	567	138	118	2,237
Liabilities					
Current liabilities, including current portion of debt and capital lease obligations	$ 34	$ 40	$ 95	$ 5	$ 174
Debt and capital lease obligations, less current portion	990	—	—	38	1,028

	December 31, 2017				
	VLP	DGD	Central Mexico Terminals	Other	Total
Assets					
Cash and cash equivalents	$ 42	$ 123	$ 1	$ 13	$ 179
Other current assets	2	66	4	—	72
Property, plant, and equipment, net	1,416	435	51	127	2,029
Liabilities					
Current liabilities, including current portion of debt and capital lease obligations	$ 27	$ 33	$ 26	$ 9	$ 95
Debt and capital lease obligations, less current portion	905	—	—	43	948

Non-Consolidated VIEs

We hold variable interests in VIEs that have not been consolidated because we are not considered the primary beneficiary. These non-consolidated VIEs are not material to our financial position or results of operations and are primarily accounted for as equity investments. MVP is one of our non-consolidated VIEs and is accounted for under owner accounting as described in Note 6. As of September 30, 2018, our maximum exposure to loss was $188 million, which represents our equity investment in MVP. We have not provided any financial support to MVP other than amounts previously required by our membership interest.

Table of Contents

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

9. EMPLOYEE BENEFIT PLANS

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

	Pension Plans		Other Postretirement Benefit Plans	
	2018	2017	2018	2017
Three months ended September 30:				
Service cost	$33	$31	$ 2	$ 1
Interest cost	22	21	2	3
Expected return on plan assets	(40)	(37)	—	—
Amortization of:				
Net actuarial (gain) loss	16	13	(1)	—
Prior service credit	(5)	(5)	(2)	(4)
Special charges	2	3	—	—
Net periodic benefit cost	$28	$26	$ 1	$ —
Nine months ended September 30:				
Service cost	$100	$92	$ 5	$ 4
Interest cost	68	64	7	8
Expected return on plan assets	(122)	(112)	—	—
Amortization of:				
Net actuarial (gain) loss	49	40	(2)	(2)
Prior service credit	(14)	(15)	(8)	(12)
Special charges	7	3	—	—
Net periodic benefit cost (credit)	$88	$72	$ 2	$ (2)

The components of net periodic benefit cost (credit) other than the service cost component (i.e., the non-service cost components) are included in the line item other income, net in the statements of income.

We contributed $132 million and $104 million, respectively, to our pension plans and $15 million and $17 million, respectively, to our other postretirement benefit plans during the nine months ended September 30, 2018 and 2017. Of the $132 million contributed to our pension plans during the nine months ended September 30, 2018, $110 million was discretionary and was contributed during the third quarter of 2018.

As a result of the discretionary pension contributions discussed above, our expected contributions to our pension plans have increased to $141 million for 2018. Our anticipated contributions to our other postretirement benefit plans during 2018 have not changed from the amount previously disclosed in our financial statements for the year ended December 31, 2017.

Table of Contents

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

10. INCOME TAXES

On December 22, 2017, Tax Reform was enacted, which resulted in significant changes to the U.S. Internal Revenue Code of 1986, as amended (the Code), and was effective beginning on January 1, 2018. Tax Reform introduced significant and complex changes to the Code, and regulatory guidance from the Internal Revenue Service (IRS) is needed in order to properly account for many of the changes. In response, the SEC issued Staff Accounting Bulletin No. 118, "Income Tax Accounting Implications of the Tax Cuts and Jobs Act," that was codified through the issuance of ASU No. 2018-05 as described in Note 1, which requires that the effects of Tax Reform be recorded for items where the accounting is complete, as well as for items where a reasonable estimate can be made (referred to as provisional amounts). For items where reasonable estimates cannot be made, provisional amounts should not be recorded and those items should continue to be accounted for under the Code prior to changes from Tax Reform until a reasonable estimate can be made.

We recorded the effects of Tax Reform for the year ended December 31, 2017 in accordance with ASU No. 2018-05, which included provisional amounts associated with the one-time transition tax on the deemed repatriation of previously undistributed accumulated earnings and profits of our international subsidiaries. We also identified items where reasonable estimates could not be made at that time.

We did not revise our initial provisional estimate during the three and nine months ended September 30, 2018, and we have not completed our accounting for the income tax effects of Tax Reform. We continue to gather additional information in order to revise our initial estimates. Any adjustments to our initial estimates will be recorded in the fourth quarter of 2018.

Table of Contents

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

11. EARNINGS PER COMMON SHARE

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

	Three Months Ended September 30,			
	2018		2017	
	Participating Securities	Common Stock	Participating Securities	Common Stock
Earnings per common share:				
Net income attributable to Valero stockholders		$ 856		$ 841
Less dividends paid:				
Common stock		340		308
Participating securities		1		1
Undistributed earnings		$ 515		$ 532
Weighted-average common shares outstanding	1	425	2	439
Earnings per common share:				
Distributed earnings	$0.80	$ 0.80	$0.70	$ 0.70
Undistributed earnings	1.21	1.21	1.21	1.21
Total earnings per common share	$2.01	$ 2.01	$1.91	$ 1.91
Earnings per common share – assuming dilution:				
Net income attributable to Valero stockholders		$ 856		$ 841
Weighted-average common shares outstanding		425		439
Common equivalent shares		2		2
Weighted-average common shares outstanding – assuming dilution		427		441
Earnings per common share – assuming dilution		$ 2.01		$ 1.91

Table of Contents

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

	Nine Months Ended September 30,			
	2018		2017	
	Participating Securities	Common Stock	Participating Securities	Common Stock
Earnings per common share:				
Net income attributable to Valero stockholders		$ 2,170		$ 1,694
Less dividends paid:				
Common stock		1,028		933
Participating securities		3		3
Undistributed earnings		$ 1,139		$ 758
Weighted-average common shares outstanding	1	428	2	444
Earnings per common share:				
Distributed earnings	$2.40	$ 2.40	$2.10	$ 2.10
Undistributed earnings	2.65	2.65	1.70	1.70
Total earnings per common share	$5.05	$ 5.05	$3.80	$ 3.80
Earnings per common share – assuming dilution:				
Net income attributable to Valero stockholders		$ 2,170		$ 1,694
Weighted-average common shares outstanding		428		444
Common equivalent shares		2		2
Weighted-average common shares outstanding – assuming dilution		430		446
Earnings per common share – assuming dilution		$ 5.05		$ 3.80

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

12. REVENUES AND SEGMENT INFORMATION

Revenue from Contracts with Customers

Disaggregation of Revenue
Revenue is presented in the table below under “Segment Information” disaggregated by product because this is the level of disaggregation that management has determined to be beneficial to users of our financial statements.

Receivables from Contracts with Customers
Our receivables from contracts with customers are included in receivables, net and totaled $6.0 billion and $5.7 billion as of September 30, 2018 and January 1, 2018, respectively.

Table of Contents

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

Remaining Performance Obligations
The majority of our contracts with customers are spot contracts and therefore have no remaining performance obligations. Our remaining contracts with customers are primarily term contracts. The transaction price for these term contracts includes an immaterial fixed amount and variable consideration (i.e., a commodity price). The variable consideration is allocated entirely to a wholly unsatisfied promise to transfer a distinct good that forms part of a single performance obligation; therefore, the variable consideration is not included in the remaining performance obligation. As of September 30, 2018, after excluding contracts with an original expected duration of one year or less, the aggregate amount of the transaction price allocated to our remaining performance obligations was not material as the transaction price for these contracts includes only an immaterial fixed amount.

Segment Information
We have three reportable segments – refining, ethanol, and VLP. Each segment is a strategic business unit that offers different products and services by employing unique technologies and marketing strategies and whose operations and operating performance are managed and evaluated separately. Operating performance is measured based on the operating income generated by the segment, which includes revenues and expenses that are directly attributable to the management of the respective segment. Intersegment sales are generally derived from transactions made at prevailing market rates. The following is a description of each segment’s business operations.

- The refining segment includes the operations of our 15 petroleum refineries, the associated marketing activities, and certain logistics assets that support our refining operations that are not owned by VLP. The principal products manufactured by our refineries and sold by this segment include gasolines and blendstocks (e.g., conventional gasolines, premium gasolines, and gasoline meeting the specifications of the California Air Resources Board (CARB)), distillates (e.g., diesel, low-sulfur diesel, ultra-low-sulfur diesel, CARB diesel, jet fuel, and other distillates), and other products (e.g., asphalt, petrochemicals, lubricants, and other refined petroleum products).
- The ethanol segment includes the operations of our 11 ethanol plants, the associated marketing activities, and logistics assets that support our ethanol operations. The principal products manufactured by our ethanol plants are ethanol and distillers grains. We sell some ethanol to our refining segment for blending into gasoline, which is sold to that segment’s customers as a finished gasoline product.
- The VLP segment includes the results of VLP. VLP generates revenue from transportation and terminaling activities provided to our refining segment. All of VLP’s revenues are intersegment revenues that are generated under commercial agreements with our refining segment. Revenues generated under these agreements are eliminated in consolidation.

Operations that are not included in any of the reportable segments are included in the corporate category.

Table of Contents

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

The following table reflects the components of operating income by reportable segment (in millions):

	Refining	Ethanol	VLP	Corporate and Eliminations	Total
Three months ended September 30, 2018:					
Revenues:					
Revenues from external customers	$29,984	$ 864	$ —	$ 1	$30,849
Intersegment revenues	5	68	140	(213)	—
Total revenues	29,989	932	140	(212)	30,849
Cost of sales:					
Cost of materials and other	27,137	776	—	(212)	27,701
Operating expenses (excluding depreciation and amortization expense reflected below)	1,047	116	31	(1)	1,193
Depreciation and amortization expense	466	19	19	—	504
Total cost of sales	28,650	911	50	(213)	29,398
Other operating expenses	10	—	—	—	10
General and administrative expenses (excluding depreciation and amortization expense reflected below)	—	—	—	209	209
Depreciation and amortization expense	—	—	—	13	13
Operating income by segment	$1,329	$ 21	$ 90	$ (221)	$1,219
Three months ended September 30, 2017:					
Revenues:					
Revenues from external customers	$22,728	$ 834	$ —	$ —	$23,562
Intersegment revenues	1	48	110	(159)	—
Total revenues	22,729	882	110	(159)	23,562
Cost of sales:					
Cost of materials and other	19,818	669	—	(158)	20,329
Operating expenses (excluding depreciation and amortization expense reflected below)	996	114	26	(1)	1,135
Depreciation and amortization expense	455	17	12	—	484
Total cost of sales	21,269	800	38	(159)	21,948
Other operating expenses	41	—	3	—	44
General and administrative expenses (excluding depreciation and amortization expense reflected below)	—	—	—	225	225
Depreciation and amortization expense	—	—	—	13	13
Operating income by segment	$1,419	$ 82	$ 69	$ (238)	$1,332

Table of Contents

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

	Refining	Ethanol	VLP	Corporate and Eliminations	Total
Nine months ended September 30, 2018:					
Revenues:					
Revenues from external customers	$85,675	$2,625	$—	$ 3	$88,303
Intersegment revenues	10	156	407	(573)	—
Total revenues	85,685	2,781	407	(570)	88,303
Cost of sales:					
Cost of materials and other	77,608	2,279	—	(570)	79,317
Operating expenses (excluding depreciation and amortization expense reflected below)	3,013	336	93	(3)	3,439
Depreciation and amortization expense	1,385	57	57	—	1,499
Total cost of sales	82,006	2,672	150	(573)	84,255
Other operating expenses	41	—	—	—	41
General and administrative expenses (excluding depreciation and amortization expense reflected below)	—	—	—	695	695
Depreciation and amortization expense	—	—	—	39	39
Operating income by segment	$3,638	$109	$257	$ (731)	$3,273
Nine months ended September 30, 2017:					
Revenues:					
Revenues from external customers	$65,030	$2,558	$—	$ —	$67,588
Intersegment revenues	1	136	326	(463)	—
Total revenues	65,031	2,694	326	(463)	67,588
Cost of sales:					
Cost of materials and other	57,662	2,166	—	(462)	59,366
Operating expenses (excluding depreciation and amortization expense reflected below)	2,966	330	75	(1)	3,370
Depreciation and amortization expense	1,358	63	36	—	1,457
Total cost of sales	61,986	2,559	111	(463)	64,193
Other operating expenses	41	—	3	—	44
General and administrative expenses (excluding depreciation and amortization expense reflected below)	—	—	—	592	592
Depreciation and amortization expense	—	—	—	39	39
Operating income by segment	$3,004	$135	$212	$ (631)	$2,720

Table of Contents

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

The following table provides a disaggregation of revenues by reportable segment (in millions). Refining and ethanol segment revenues are disaggregated for our principal products, and VLP segment revenues are disaggregated by activity type.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Refining:				
Gasolines and blendstocks	$12,664	$10,310	$35,810	$29,368
Distillates	14,052	10,477	41,169	29,909
Other product revenues	3,273	1,942	8,706	5,754
Total refining revenues	29,989	22,729	85,685	65,031
Ethanol:				
Ethanol	755	740	2,240	2,290
Distillers grains	177	142	541	404
Total ethanol revenues	932	882	2,781	2,694
VLP:				
Pipeline transportation	31	23	93	71
Terminaling	107	86	309	253
Storage and other	2	1	5	2
Total VLP revenues	140	110	407	326
Corporate – other revenues	1	—	3	—
Elimination of intersegment revenues	(213)	(159)	(573)	(463)
Revenues	$30,849	$23,562	$88,303	$67,588

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

	September 30, 2018	December 31, 2017
Refining	$ 44,168	$ 40,382
Ethanol	1,312	1,344
VLP	1,600	1,517
Corporate and eliminations	4,814	6,915
Total assets	$ 51,894	$ 50,158

Table of Contents

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

13. 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):

	Nine Months Ended September 30,	
	2018	2017
Decrease (increase) in current assets:		
Receivables, net	$(1,307)	$74
Inventories	(1,134)	(285)
Prepaid expenses and other	(65)	138
Increase (decrease) in current liabilities:		
Accounts payable	1,890	227
Accrued expenses	(168)	121
Taxes other than income taxes payable	(32)	78
Income taxes payable	(358)	191
Changes in current assets and current liabilities	$(1,174)	$544

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

	Nine Months Ended September 30,	
	2018	2017
Interest paid in excess of amount capitalized	$344	$356
Income taxes paid, net	1,116	357

Noncash investing and financing activities during the nine months ended September 30, 2018 included the recognition of terminal assets and related obligation totaling $160 million under owner accounting as described in Note 6. Noncash investing and financing activities during the nine months ended September 30, 2017 included the recognition of (i) capital lease assets and related obligations totaling approximately $490 million for the lease of storage tanks located at three of our refineries and (ii) terminal assets and related obligation totaling $55 million under owner accounting as described in Note 6.

Table of Contents

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

14. FAIR VALUE MEASUREMENTS

Recurring Fair Value Measurements
The following tables 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 September 30, 2018 and December 31, 2017.

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 in the following tables on a gross basis. We have no derivative contracts that are subject to master netting arrangements that are reflected gross on the balance sheet.

	September 30, 2018							
	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	$2,072	$ 12	$ —	$2,084	$(2,058)	$ —	$ 26	$ —
Investments of certain benefit plans	63	—	9	72	n/a	n/a	72	n/a
Total	$2,135							