



Valero Energy Corporation (VLO)

Updated October 28th, 2018 by Aristofanis Papadatos

Key Metrics

Current Price:	\$86	5 Year CAGR Estimate:	4.3%	Volatility Percentile:	71.8%
Fair Value Price:	\$65	5 Year Growth Estimate:	6.0%	Momentum Percentile:	82.0%
% Fair Value:	132%	5 Year Valuation Multiple Estimate:	-5.4%	Growth Percentile:	47.6%
Dividend Yield:	3.7%	5 Year Price Target	\$87	Valuation Percentile:	8.4%
Dividend Risk Score:	D	Retirement Suitability Score:	C	Total Return Percentile:	12.8%

Overview & Current Events

Now that Marathon Petroleum has acquired Andeavor, Valero has become the second largest petroleum refiner in the U.S. It owns 15 refineries in the U.S., Canada and the U.K. and has a total capacity of about 3.1 M barrels/day. It also has a midstream segment, Valero Energy Partners LP, but its contribution to total earnings is under 10%. Valero should be viewed as a nearly pure play downstream refining business.

Valero recently announced that it will acquire Valero Energy Partners LP for about \$950 million. On the same day, the stock plunged 10% but for another season. It was rumored that the U.S. government was trying to postpone the implementation of the new international marine rules in the U.S. As per these rules, vessels that sail in international waters will be forced to burn low-sulfur diesel instead of heavy fuel oil from January, 2020. As diesel is much more expensive than fuel oil, the new standard will greatly benefit refiners. It was natural that the rumor for a potential delay of the standard triggered a sell-off of domestic refiners, though refiners will likely eventually benefit from the new rules at some point in the future.

Valero reported its financial results for the third quarter of fiscal 2018 two days ago. The refiner exceeded the earnings-per-share analysts' estimates (\$2.01 vs. \$1.96), mostly thanks to its remarkable 99% capacity utilization and a 59% decrease in its biofuel blending costs.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	-\$2.16	-\$0.65	\$1.62	\$3.69	\$3.75	\$4.37	\$6.85	\$7.99	\$4.94	\$4.96	\$6.52	\$8.73
DPS	\$0.57	\$0.60	\$0.20	\$0.30	\$0.65	\$0.85	\$1.05	\$1.70	\$2.40	\$2.80	\$3.20	\$4.40
Shares	524	541	568	569	556	548	530	500	464	444	420	375

U.S. refiners have enjoyed strong margins in recent years thanks to the suppressed oil prices, which greatly increased the demand for refined products and thus boosted refining margins. However, the oil market has markedly tightened thanks to the efforts of OPEC and Russia and supply disruptions in Iran, Venezuela and Libya. As a result, the oil price has rallied to an almost 4-year high and is likely to remain elevated in the years ahead. This will probably provide a strong headwind for the refining margins.

Due to margin pressure, we have lowered our earnings-per-share estimate for this year from \$7.23 to \$6.52. Refining is a highly cyclical business and it now seems to be closer to its peak than to its bottom. On the other hand, Valero is likely to continue to reduce its share count by about 4% per year. All in all, it is prudent to assume no more than 6.0% average annual earnings-per-share growth over the next five years.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	N/A	N/A	11.5	6.7	7.2	9.2	7.5	7.7	11.9	14.3	13.2	10.0
Avg. Yld.	1.5%	3.1%	1.1%	1.2%	2.4%	2.1%	2.0%	2.8%	4.1%	4.0%	3.7%	5.1%

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



Valero Energy Corporation (VLO)

Updated October 28th, 2018 by Aristofanis Papadatos

In our previous research report, we mentioned that Valero had become clearly overvalued. Our thesis has proven correct, as the stock has plunged 30% since then. The stock is now trading at a P/E ratio of 13.2, which is still higher than our assumed fair P/E ratio of 10.0 for this stock. If the stock approaches our fair valuation estimate, it will incur a 5.4% annualized drag due to the contraction of its P/E ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	21.1%	6.3%	20.7%	24.0%	26.8%	22.8%	27.9%	16.1%	9.5%	9.1%	10.0%	15.0%
Debt/A	54.6%	58.6%	60.1%	61.6%	59.3%	57.8%	53.4%	51.7%	54.8%	54.3%	57.0%	53.0%
Int. Cov.	2.5	0.2	4.1	9.3	16.1	11.9	15.0	14.8	8.1	7.9	9.0	10.0
Payout	N/A	N/A	12.3%	8.1%	17.3%	19.5%	15.3%	21.3%	48.6%	56.5%	49.1%	50.4%
Std. Dev.	53.9%	44.9%	28.1%	47.4%	36.3%	41.0%	27.3%	29.6%	31.8%	16.7%	17.0%	20.0%

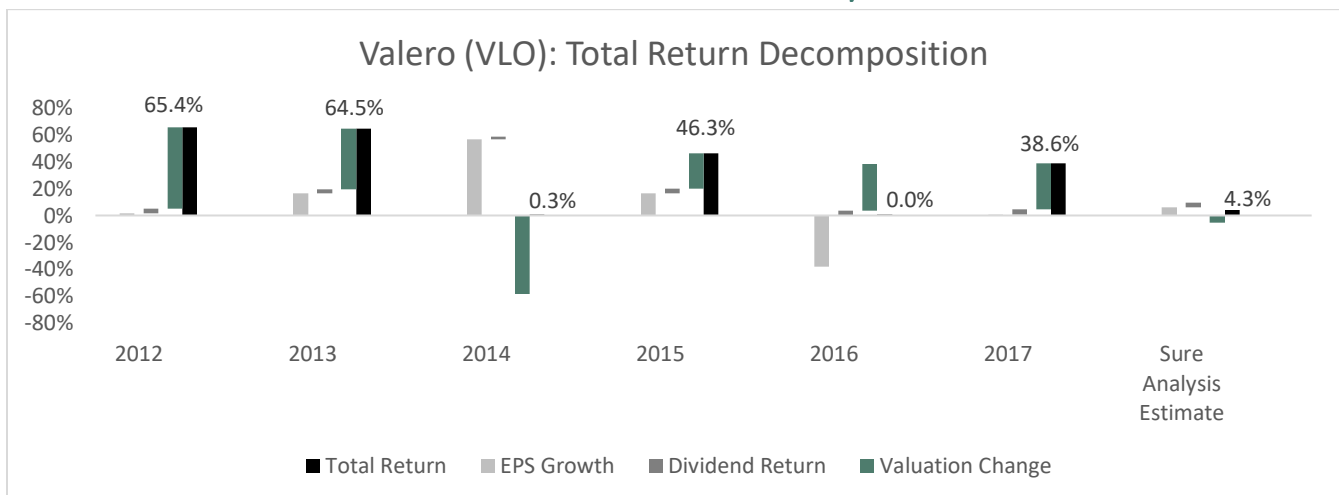
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and thus gasoline became cheaper than crude oil for almost three months. As a result, Valero posted operating losses. On the other hand, Valero has a competitive advantage over its peers, namely the high complexity of its refineries, which enables the company to benefit the most from the gyrations of the prices of oil and refined products by optimizing its blend of feedstock and products.

Nevertheless, investors should note that U.S. refiners have now lost a significant advantage of the past. During the fierce downturn of the refining sector within 2011-2013, about 20% of refineries worldwide went out of business. The domestic refiners were not affected, as they were protected thanks to the ban on oil exports that prevailed back then. However, now that the ban has been lifted, they will be more vulnerable whenever the next downturn shows up.

Final Thoughts & Recommendation

In our last research report, we advised investors to sell Valero due to its overvalued status. Our thesis has played out, as the stock has plunged 30% since then. According to our calculations, the stock can now offer a 4.3% average annual return over the next five years. While the company is well managed, its performance is mostly determined by the underlying refining margins, which have probably peaked. As a result, the stock still fails to earn a buy rating.

Total Return Breakdown by Year



[Click here to rate and review this research report. Your feedback is important to us.](#)

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.



Valero Energy Corporation (VLO)

Updated October 28th, 2018 by Aristofanis Papadatos

Income Statement Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Revenue (\$B)	113.1	64.60	82.23	125.99	138.39	138.07	130.84	87.80	75.66	93.98
Gross Profit	7260	2238	7775	10268	11908	10758	12703	7115	4391	4547
Gross Margin	6.4%	3.5%	9.5%	8.2%	8.6%	7.8%	9.7%	8.1%	5.8%	4.8%
SG&A Exp.	1327	572	531	571	698	758	724	710	715	835
D&A Exp.	1476	1527	1473	1534	1574	1720	1690	1842	1894	1986
Operating Profit	4875	305	1878	3680	5130	3957	5902	6358	3628	3599
Operating Margin	4.3%	0.5%	2.3%	2.9%	3.7%	2.9%	4.5%	7.2%	4.8%	3.8%
Net Profit	-1131	-1982	324	2090	2083	2720	3630	3990	2289	4065
Net Margin	-1.0%	-3.1%	0.4%	1.7%	1.5%	2.0%	2.8%	4.5%	3.0%	4.3%
Free Cash Flow	202	-483	1315	1683	2339	3443	2088	3993	3542	4103
Income Tax	1539	-43	575	1226	1626	1254	1777	1870	765	-949

Balance Sheet Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total Assets	34417	35572	37621	42783	44477	47260	45550	44227	46173	50158
Cash & Equivalents	940	825	3334	1024	1723	4292	3689	4114	4816	5850
Acc. Receivable	2895	3779	4583	8366	8061	8582	5509	4105	5687	6786
Inventories	4620	4578	4947	5623	5973	5758	6623	5898	5709	6384
Goodwill & Int.	224	227	224	227	213	N/A	154	156	148	142
Total Liabilities	18797	20847	22596	26338	26382	27314	24306	22873	25319	27258
Accounts Payable	4323	5825	6441	9472	9348	9931	6760	4907	6357	8348
Long-Term Debt	312	237	822	7741	7049	6564	6386	7335	8001	8872
Total Equity	15620	14725	15025	16423	18032	19460	20677	20527	20024	21991
D/E Ratio	0.02	0.02	0.05	0.47	0.39	0.34	0.31	0.36	0.40	0.40

Profitability & Per Share Metrics

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Return on Assets	-2.9%	-5.7%	0.9%	5.2%	4.8%	5.9%	7.8%	8.9%	5.1%	8.4%
Return on Equity	-6.6%	-13.1%	2.2%	13.3%	12.1%	14.5%	18.1%	19.4%	11.3%	19.4%
ROIC	-5.5%	-12.8%	2.1%	10.4%	8.4%	10.5%	13.4%	14.2%	8.0%	13.4%
Shares Out.	524	541	568	569	556	548	530	500	464	444
Revenue/Share	215.9	119.41	144.78	221.42	248.91	251.96	246.88	175.61	163.06	211.67
FCF/Share	0.39	-0.89	2.32	2.96	4.21	6.28	3.94	7.99	7.63	9.24

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.

Disclaimer

Nothing presented herein is, or is intended to constitute, specific investment advice. Nothing in this research report should be construed as a recommendation to follow any investment strategy or allocation. Any forward-looking statements or forecasts are based on assumptions and actual results are expected to vary from any such statements or forecasts. No reliance should be placed on any such statements or forecasts when making any investment decision. While Sure Dividend has used reasonable efforts to obtain information from reliable sources, we make no representations or warranties as to the accuracy, reliability or completeness of third-party information presented herein. No guarantee of investment performance is being provided and no inference to the contrary should be made. There is a risk of loss from an investment in marketable securities. Past performance is not a guarantee of future performance.