



Valero Energy Corporation (VLO)

Updated January 31st, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	\$88	5 Year CAGR Estimate:	6.9%	Market Cap:	\$36.0 B
Fair Value Price:	\$95	5 Year Growth Estimate:	1.0%	Ex-Dividend Date:	2/11/2020 ¹
% Fair Value:	93%	5 Year Valuation Multiple Estimate:	1.5%	Dividend Payment Date:	3/8/2020 ¹
Dividend Yield:	4.5%	5 Year Price Target	\$100	Years Of Dividend Growth:	10
Dividend Risk Score:	C	Retirement Suitability Score:	A	Last Dividend Increase:	8.9%

Overview & Current Events

After the acquisition of Andeavor by Marathon Petroleum, Valero – a \$36 billion market cap business - 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 and the other refiners will greatly benefit from the new international marine rules, which have come in effect since January 1st, 2020. As per these rules, vessels that sail in international waters are now forced to burn low-sulfur diesel instead of heavy fuel oil. Diesel is much more expensive than fuel oil, so the new standard will greatly benefit refiners. Valero is one of the refiners that will benefit the most from the new marine standard, as it has many complex coastal refineries, which can process sour (cheap) crude oil and convert its low-value products to high-value products.

In late January, Valero reported (1/30/20) its financial results for the fourth quarter of fiscal 2019. The operating income of the refining segment dipped from \$1.5 billion in prior year's quarter to \$1.4 billion and adjusted earnings-per-share fell from \$2.19 to \$2.13. While these results may seem uninspiring on the surface, they were actually very strong. The fourth quarter of 2018 had been exceptionally strong thanks to record-high discount of Canadian crude to WTI. The main reason that the Q4 2019 results almost matched Q4 2018 results was the new marine standard, as prices of products adjusted before the implementation of the new standard. Earnings-per-share exceeded analysts' consensus by an impressive \$0.50. The refiner has not missed analysts' earnings-per-share estimates for 15 quarters in a row.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	\$1.62	\$3.69	\$3.75	\$4.37	\$6.85	\$7.99	\$4.94	\$4.96	\$7.37	\$5.70	\$9.50	\$9.98
DPS	\$0.20	\$0.30	\$0.65	\$0.85	\$1.05	\$1.70	\$2.40	\$2.80	\$3.20	\$3.60	\$3.92	\$5.00
Shares²	568	569	556	548	530	500	464	444	422	410	400	340

We expect Valero to grow its earnings-per-share from \$5.70 to \$9.50 this year thanks to the new international marine standard, which is a game changer for refiners. Beyond this year, we expect only 1% average annual growth, as the effect of growth projects and share repurchases will be partly offset by a modest fading of the boost from the new marine standard due to higher total refining capacity. Valero recently commissioned its new alkylation unit, which will enhance the margins of its Houston refinery, and has a promising pipeline of growth projects for the next three years.

Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	11.5	6.7	7.2	9.2	7.5	7.7	11.9	14.3	13.8	14.9	9.3	10.0
Avg. Yld.	1.1%	1.2%	2.4%	2.1%	2.0%	2.8%	4.1%	4.0%	3.1%	4.2%	4.5%	5.0%

¹ Estimated date.

² In millions.

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.



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Valero is currently trading at a price-to-earnings ratio of 9.3, which is lower than our assumed fair price-to-earnings ratio of 10.0 for this stock. If the stock approaches our fair valuation estimate, it will enjoy a 1.5% annualized gain thanks to price-to-earnings expansion.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	12.3%	8.1%	17.3%	19.5%	15.3%	21.3%	48.6%	56.5%	43.4%	63.2%	41.3%	50.1%

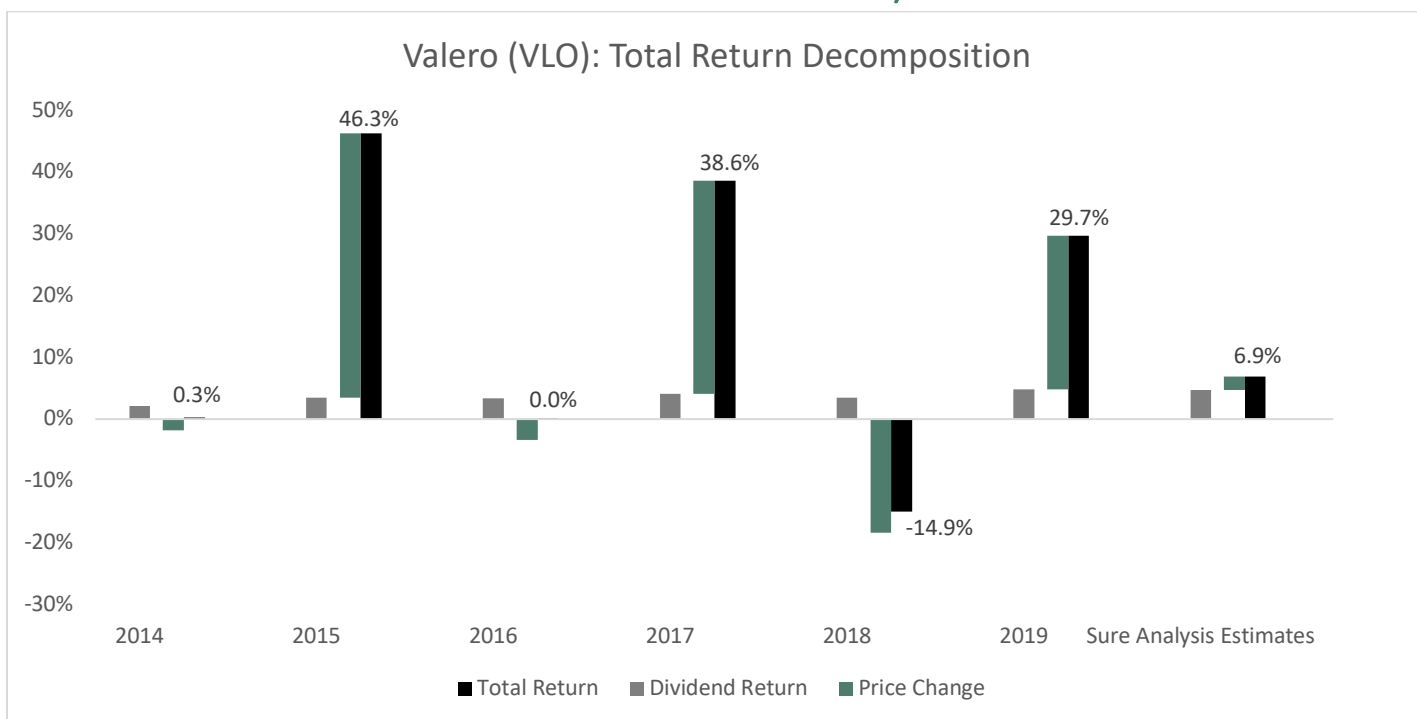
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and thus gasoline became cheaper than crude oil for almost three months. 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 from the gyrations of oil prices and refined products by optimizing its blend of feedstock and products.

Nevertheless, investors should note that U.S. refiners have now lost a significant past advantage. 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

Valero has promising growth prospects ahead thanks to IMO 2020 and has become more attractive thanks to its recent correction. However, the stock has not reached bargain territory yet. We expect Valero to offer a 6.9% average annual return over the next five years thanks to its 4.5% dividend, 1% annualized earnings-per-share growth beyond this year and a modest expansion of its valuation level. We thus rate the stock as a hold.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue (\$B)	82.23	125.99	138.39	138.07	130.84	87.80	75.66	93.98	117.03	
Gross Profit	3814	5785	7377	6435	8316	7115	4347	4505	5594	
Gross Margin	4.6%	4.6%	5.3%	4.7%	6.4%	8.1%	5.7%	4.8%	4.8%	
SG&A Exp.	531	571	698	758	724	710	709	829	925	
D&A Exp.	1473	1534	1574	1720	1690	1842	1894	1986	2069	
Operating Profit	1878	3680	5130	3957	5902	6358	3590	3563	4572	
Operating Margin	2.3%	2.9%	3.7%	2.9%	4.5%	7.2%	4.7%	3.8%	3.9%	
Net Profit	324	2090	2083	2720	3630	3990	2289	4065	3122	
Net Margin	0.4%	1.7%	1.5%	2.0%	2.8%	4.5%	3.0%	4.3%	2.7%	
Free Cash Flow	1315	1683	2339	3443	2088	3993	3542	4103	2619	
Income Tax	575	1226	1626	1254	1777	1870	765	-949	879	

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	37621	42783	44477	47260	45550	44227	46173	50158	50155	
Cash & Equivalents	3334	1024	1723	4292	3689	4114	4816	5850	2982	
Acc. Receivable	4583	8366	8061	8582	5509	4105	5687	6784	6984	
Inventories	4947	5623	5973	5758	6623	5898	5709	6384	6532	
Goodwill & Int.	224	227	213	N/A	154	156	148	142	567	
Total Liabilities	22596	26338	26382	27314	24306	22873	25319	27258	27424	
Accounts Payable	6441	9472	9348	9931	6760	4907	6357	8348	8594	
Long-Term Debt	822	7741	7049	6564	6386	7335	8001	8872	9109	
Total Equity	15025	16423	18032	19460	20677	20527	20024	21991	21667	
D/E Ratio	0.05	0.47	0.39	0.34	0.31	0.36	0.40	0.40	0.42	

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	0.9%	5.2%	4.8%	5.9%	7.8%	8.9%	5.1%	8.4%	6.2%	
Return on Equity	2.2%	13.3%	12.1%	14.5%	18.1%	19.4%	11.3%	19.4%	14.3%	
ROIC	2.1%	10.4%	8.4%	10.5%	13.4%	14.2%	8.0%	13.4%	9.8%	
Shares Out.	568	569	556	548	530	500	464	444	422	
Revenue/Share	144.78	221.42	248.91	251.96	246.88	175.61	163.06	211.67	273.44	
FCF/Share	2.32	2.96	4.21	6.28	3.94	7.99	7.63	9.24	6.12	

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

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