Valero Energy Corporation (VLO)

Updated August 5th, 2020 by Aristofanis Papadatos

Key Metrics

Current Price:	$53	**5 Year CAGR Estimate:**	12.8%	**Market Cap:**	$22.0 B
Fair Value Price:	$62	**5 Year Growth Estimate:**	4.0%	**Ex-Dividend Date:**	8/3/2020
% Fair Value:	86%	**5 Year Valuation Multiple Estimate:**	3.2%	**Dividend Payment Date:**	9/2/2020
Dividend Yield:	7.4%	**5 Year Price Target**	$75	**Years Of Dividend Growth:**	10
Dividend Risk Score:	F	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	8.9%

Overview & Current Events

Valero, a $22 billion market cap business, is the 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 3.2 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 were poised to 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 could greatly benefit refiners. However, refiners have now been hit by the coronavirus, which has caused a severe global recession and a collapse in the demand for oil products.

In late July, Valero reported (7/30/20) its financial results for the second quarter of fiscal 2020. Refinery throughput slumped -22% over last year's quarter due to the collapse in the demand for refined products caused by the pandemic. In addition, refining margins plunged -58%. As a result, the company switched from an adjusted profit per share of $1.60 to an adjusted loss per share of -$1.25. Moreover, Valero now expects to run its refineries at 79% of their capacity in the third quarter due to the headwind from the pandemic. Due to the low throughput and the continuing poor refining margins, we now expect Valero to lose approximately -$1.80 per share this year. On the bright side, in the absence of another lockdown, we expect refining margins to improve later this year. It is also remarkable that Valero has not missed analysts' earnings-per-share estimates for 17 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	***-$1.80***	***$7.53***
DPS	$0.20	$0.30	$0.65	$0.85	$1.05	$1.70	$2.40	$2.80	$3.20	$3.60	***$3.92***	***$4.54***
Shares[1]	568	569	556	548	530	500	464	444	422	410	***406***	***350***

In order to calculate the future return of Valero, we have used its mid-cycle earnings-per-share of $6.19, which is the 5-year average. We view the headwind from the pandemic as temporary and expect the demand for oil products to recover from next year. Moreover, the new international marine standard will be a growth driver when the pandemic subsides. Furthermore, Valero has a promising pipeline of growth projects for the next three years. We thus expect the refiner to grow its earnings-per-share at a 4.0% average annual rate off its mid-cycle level until 2025.

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	***8.6***	***10.0***
Avg. Yld.	1.1%	1.2%	2.4%	2.1%	2.0%	2.8%	4.1%	4.0%	3.1%	4.2%	***7.4%***	***6.0%***

[1] In millions.

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Valero is currently trading at a price-to-earnings ratio of 8.6, 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 3.2% annualized gain thanks to the expansion of its price-to-earnings ratio.

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%	***63.3%***	***60.3%***

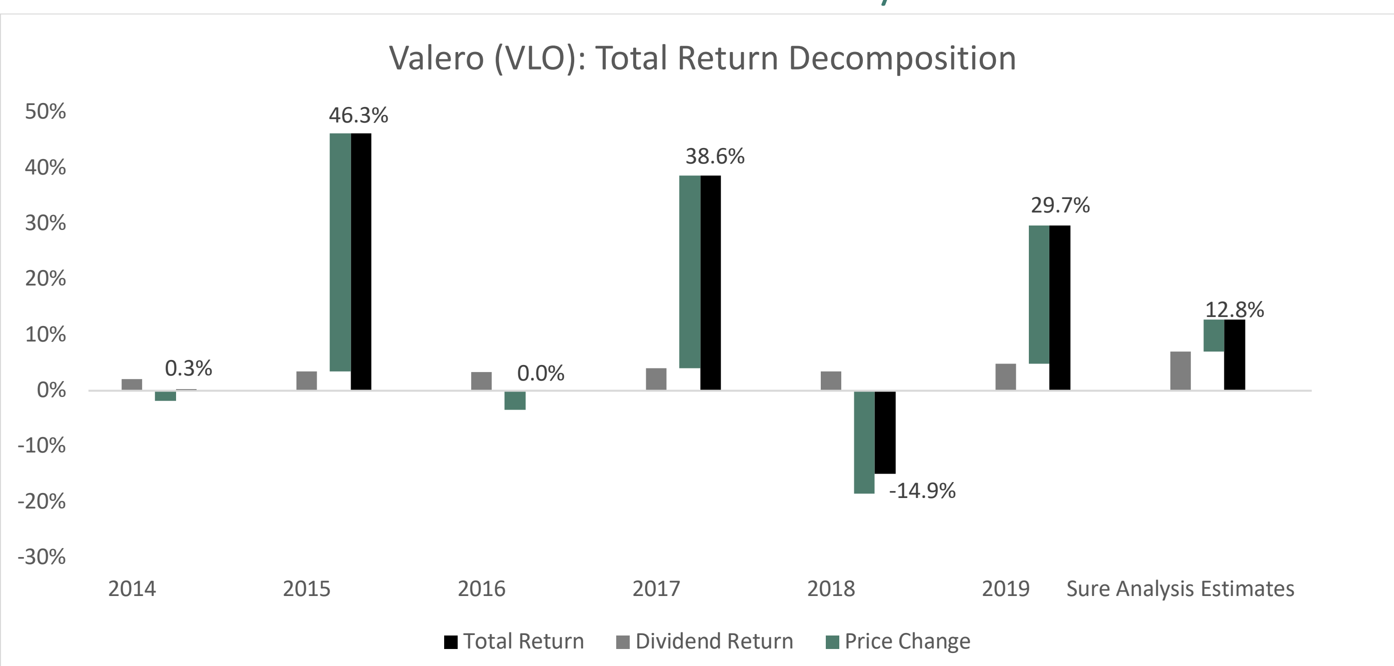
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and thus gasoline became cheaper than crude oil for almost three months. As a result, Valero posted operating losses. A similar picture is evident in the ongoing recession, as the price of crude oil has recovered more than the prices of refined products off the bottom in March, thus exerting pressure on the refining margins. On the bright side, 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 are more vulnerable in the current downturn.

Final Thoughts & Recommendation

Valero has plunged -45% in about seven months due to the collapse in the demand for oil products, which has resulted from the pandemic. We expect the demand for oil products to recover from next year and thus we expect Valero to offer a 12.8% average annual return over the next five years thanks to its 7.4% dividend, 4% annualized earnings-per-share growth off mid-cycle level and a 3.2% expansion of its valuation level. We thus rate the stock as a buy.

Total Return Breakdown by Year



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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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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	108.3
Gross Profit	3814	5785	7377	6435	8316	7115	4347	4505	5594	4778
Gross Margin	4.6%	4.6%	5.3%	4.7%	6.4%	8.1%	5.7%	4.8%	4.8%	4.4%
SG&A Exp.	531	571	698	758	724	710	709	829	925	868
D&A Exp.	1473	1534	1574	1720	1690	1842	1894	1986	2069	2255
Operating Profit	1878	3680	5130	3957	5902	6358	3590	3563	4572	3836
Operating Margin	2.3%	2.9%	3.7%	2.9%	4.5%	7.2%	4.7%	3.8%	3.9%	3.5%
Net Profit	324	2090	2083	2720	3630	3990	2289	4065	3122	2422
Net Margin	0.4%	1.7%	1.5%	2.0%	2.8%	4.5%	3.0%	4.3%	2.7%	2.2%
Free Cash Flow	1315	1683	2339	3443	2088	3993	3542	4103	2619	3537
Income Tax	575	1226	1626	1254	1777	1870	765	-949	879	702

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	53,864
Cash & Equivalents	3334	1024	1723	4292	3689	4114	4816	5850	2982	2,583
Acc. Receivable	4583	8366	8061	8582	5509	4105	5687	6784	6984	8,094
Inventories	4947	5623	5973	5758	6623	5898	5709	6384	6532	7,013
Goodwill & Int.	224	227	213	N/A	154	156	148	142	567	543
Total Liabilities	22596	26338	26382	27314	24306	22873	25319	27258	27424	31,328
Accounts Payable	6441	9472	9348	9931	6760	4907	6357	8348	8594	10,205
Long-Term Debt	822	7741	7049	6564	6386	7335	8001	8872	9109	9,672
Total Equity	15025	16423	18032	19460	20677	20527	20024	21991	21667	21,803
D/E Ratio	0.05	0.47	0.39	0.34	0.31	0.36	0.40	0.40	0.42	0.44

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%	4.7%
Return on Equity	2.2%	13.3%	12.1%	14.5%	18.1%	19.4%	11.3%	19.4%	14.3%	11.1%
ROIC	2.1%	10.4%	8.4%	10.5%	13.4%	14.2%	8.0%	13.4%	9.8%	7.6%
Shares Out.	568	569	556	548	530	500	464	444	422	410
Revenue/Share	144.78	221.42	248.91	251.96	246.88	175.61	163.06	211.67	273.44	261.65
FCF/Share	2.32	2.96	4.21	6.28	3.94	7.99	7.63	9.24	6.12	8.54

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