



Valero Energy Corporation (VLO)

Updated April 27th, 2021 by Aristofanis Papadatos

Key Metrics

Current Price:	\$71	5 Year CAGR Estimate:	6.6%	Market Cap:	\$28.8 B
Fair Value Price:	\$64	5 Year Growth Estimate:	4.0%	Ex-Dividend Date:	5/14/2021
% Fair Value:	110%	5 Year Valuation Multiple Estimate:	-1.9%	Dividend Payment Date:	6/8/2021
Dividend Yield:	5.5%	5 Year Price Target	\$78	Years Of Dividend Growth:	10
Dividend Risk Score:	F	Retirement Suitability Score:	D	Last Dividend Increase:	8.9%

Overview & Current Events

Valero, a \$28.8 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 refiner.

U.S. refiners are facing a severe downturn due to the coronavirus crisis, which has caused an unprecedented collapse in the demand for refined products. The global demand for refined products decreased from 101.2 million barrels per day in 2019 to 92.2 million barrels per day in 2020. This -9% decrease has led refining margins to plunge and hence all the U.S. refiners incurred material losses in 2020.

In late April, Valero reported (4/22/21) its financial results for the first quarter of fiscal 2021. Refinery throughput slumped -14% over last year's quarter due to the collapse in the demand for refined products caused by the pandemic. In addition, refining margins plunged and Valero incurred excess energy costs of \$579 million (\$1.15 per share) due to winter storm Uri. As a result, Valero switched from an adjusted profit of \$0.34 per share in last year's quarter to a loss of -\$1.73 per share. On the bright side, Valero stated that it will continue to expand its production of renewable diesel, though this division is too small to offset the losses in the refining business.

Thanks to the distribution of vaccines, we expect the pandemic to subside in the second half of 2021. EIA expects global oil demand to partly recover this year, from 92.2 to 97.7 million barrels per day. However, all the refiners are facing a headwind due to the aggressive production cuts of OPEC and Russia, which have greatly supported the price of oil, but pressured refining margins. Nevertheless, we still believe in the long-term prospects of Valero.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	\$3.69	\$3.75	\$4.37	\$6.85	\$7.99	\$4.94	\$4.96	\$7.37	\$5.70	-\$3.12	\$0.50	\$7.53
DPS	\$0.30	\$0.65	\$0.85	\$1.05	\$1.70	\$2.40	\$2.80	\$3.20	\$3.60	\$3.92	\$3.92	\$3.92
Shares¹	569	556	548	530	500	464	444	422	410	407	407	360

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 until 2019. We view the headwind from the pandemic as temporary and expect the demand for oil products to recover later this year. Moreover, 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 2026.

Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	6.7	7.2	9.2	7.5	7.7	11.9	14.3	13.8	14.9	---	11.5	10.4
Avg. Yld.	1.2%	2.4%	2.1%	2.0%	2.8%	4.1%	4.0%	3.1%	4.2%	6.7%	5.5%	5.0%

¹ In millions.

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Valero is currently trading at 9.4 times its mid-cycle earnings-per-share. This earnings multiple is lower than the 10-year average price-to-earnings ratio of 10.4 of the stock. If the stock trades at its average valuation level in five years, it will incur a -1.9% annualized drag due to the contraction of its price-to-earnings ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	8.1%	17.3%	19.5%	15.3%	21.3%	48.6%	56.5%	43.4%	63.2%	---	63.3%	52.1%

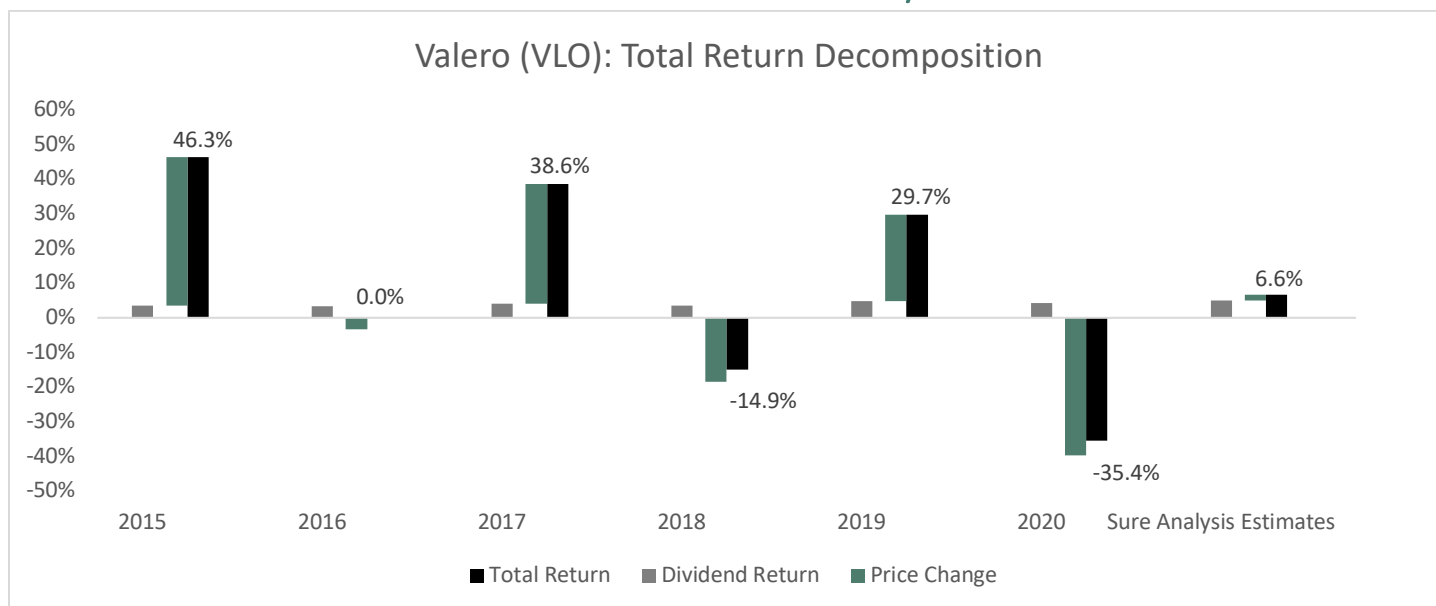
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and gasoline became cheaper than crude oil for almost three months. As a 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 a year ago, 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 and thus they all incurred material losses in 2020. If the pandemic lasts longer than expected, Valero will almost certainly cut its 5.5% dividend.

Final Thoughts & Recommendation

We expect the demand for oil products to recover in the second half of the year thanks to the distribution of vaccines worldwide. However, Valero has rallied 22% since our last research report, in January, on top of the 45% rally in the preceding three months, and hence it has become less attractive. We now expect Valero to offer a 6.6% average annual return over the next five years. We thus lower our rating from “buy” to “hold”, and we note that only patient investors, with a long-term time horizon, should consider this stock.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue (\$B)	125.99	138.39	138.07	130.84	87.80	75.66	93.98	117.03	108.3	64.9
Gross Profit	4,251	5,828	4,715	6,626	7,068	4,299	4,453	5,542	4,725	-788
Gross Margin	3.4%	4.2%	3.4%	5.1%	8.0%	5.7%	4.7%	4.7%	4.4%	-1.2%
SG&A Exp.	571	698	758	724	710	709	829	925	868	756
D&A Exp.	1,534	1,574	1,720	1,690	1,842	1,894	1,986	2,069	2,255	2,351
Operating Profit	3,680	5,130	3,957	5,902	6,358	3,590	3,563	4,572	3,836	-1,579
Operating Margin	2.9%	3.7%	2.9%	4.5%	7.2%	4.7%	3.8%	3.9%	3.5%	-2.4%
Net Profit	2,090	2,083	2,720	3,630	3,990	2,289	4,065	3,122	2,422	-1,421
Net Margin	1.7%	1.5%	2.0%	2.8%	4.5%	3.0%	4.3%	2.7%	2.2%	-2.2%
Free Cash Flow	1,683	2,339	3,443	2,088	3,993	3,542	4,103	2,619	3,537	-840
Income Tax	1,226	1,626	1,254	1,777	1,870	765	-949	879	702	-903

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	42783	44477	47260	45550	44227	46173	50158	50155	53,864	51,774
Cash & Equivalents	1024	1723	4292	3689	4114	4816	5850	2982	2,583	3,313
Acc. Receivable	8366	8061	8582	5509	4105	5687	6784	6984	8,094	4,807
Inventories	5623	5973	5758	6623	5898	5709	6384	6532	7,013	6,038
Goodwill & Int.	227	213	N/A	154	156	148	142	567	543	508
Total Liabilities	26338	26382	27314	24306	22873	25319	27258	27424	31,328	32,132
Accounts Payable	9472	9348	9931	6760	4907	6357	8348	8594	10,205	6,082
Long-Term Debt	7741	7049	6564	6386	7335	8001	8872	9109	9,672	14,677
Total Equity	16423	18032	19460	20677	20527	20024	21991	21667	21,803	18,801
D/E Ratio	0.47	0.39	0.34	0.31	0.36	0.40	0.40	0.42	0.44	0.78

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	5.2%	4.8%	5.9%	7.8%	8.9%	5.1%	8.4%	6.2%	4.7%	-2.7%
Return on Equity	13.3%	12.1%	14.5%	18.1%	19.4%	11.3%	19.4%	14.3%	11.1%	-7.0%
ROIC	10.4%	8.4%	10.5%	13.4%	14.2%	8.0%	13.4%	9.8%	7.6%	-4.3%
Shares Out.	569	556	548	530	500	464	444	422	410	407
Revenue/Share	221.42	248.91	251.96	246.88	175.61	163.06	211.67	273.44	261.65	159.49
FCF/Share	2.96	4.21	6.28	3.94	7.99	7.63	9.24	6.12	8.54	-2.06

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

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