



# Valero Energy Corporation (VLO)

Updated January 28<sup>th</sup>, 2022 by Aristofanis Papadatos

## Key Metrics

|                             |      |  |       |                                  |          |
|-----------------------------|------|--|-------|----------------------------------|----------|
| <b>Current Price:</b>       | \$82 | <b>5 Year CAGR Estimate:</b>               | 4.3%  | <b>Market Cap:</b>               | \$33.2 B |
| <b>Fair Value Price:</b>    | \$67 | <b>5 Year Growth Estimate:</b>             | 4.0%  | <b>Ex-Dividend Date:</b>         | 2/2/2022 |
| <b>% Fair Value:</b>        | 122% | <b>5 Year Valuation Multiple Estimate:</b> | -4.0% | <b>Dividend Payment Date:</b>    | 3/3/2022 |
| <b>Dividend Yield:</b>      | 4.8% | <b>5 Year Price Target</b>                 | \$81  | <b>Years Of Dividend Growth:</b> | 0        |
| <b>Dividend Risk Score:</b> | F    | <b>Retirement Suitability Score:</b>       | C     | <b>Last Dividend Increase:</b>   | N/A      |

## Overview & Current Events

Valero, a \$33.2 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 produces renewable diesel and 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 faced a severe downturn in 2020-2021 due to the coronavirus crisis, which 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 led refining margins to plunge and hence all the U.S. refiners incurred material losses in 2020. However, thanks to the distribution of vaccines, the pandemic has begun to subside. EIA expects global oil demand to recover to its pre-pandemic level this year.

In late January, Valero reported (1/27/22) its financial results for the fourth quarter of fiscal 2021. Thanks to a strong recovery in the demand for oil products, Valero enhanced its refinery throughput from 2.5 million barrels per day in the prior year's quarter to 3.0 million barrels per day and enjoyed higher refining margins. As a result, the refining segment switched from an operating loss of -\$476 million in the prior year's quarter to operating income of \$1.1 billion and Valero switched from an adjusted loss of -\$1.06 per share in the prior year's quarter to a profit of \$2.47 per share, thus exceeding analysts' consensus by an impressive \$0.65. Even better, refining margins are currently at multi-year highs thanks to strong demand for oil products, low inventories of light distillates (mainly gasoline) and the permanent shutdown of some refineries around the globe in the last two years due to the pandemic.

## Growth on a Per-Share Basis

| Year                      | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020    | 2021   | 2022          | 2027          |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|---------|--------|---------------|---------------|
| <b>EPS</b>                | \$3.75 | \$4.37 | \$6.85 | \$7.99 | \$4.94 | \$4.96 | \$7.37 | \$5.70 | -\$3.12 | \$2.81 | <b>\$6.20</b> | <b>\$7.54</b> |
| <b>DPS</b>                | \$0.65 | \$0.85 | \$1.05 | \$1.70 | \$2.40 | \$2.80 | \$3.20 | \$3.60 | \$3.92  | \$3.92 | <b>\$3.92</b> | <b>\$3.92</b> |
| <b>Shares<sup>1</sup></b> | 556    | 548    | 530    | 500    | 464    | 444    | 422    | 410    | 407     | 408    | <b>408</b>    | <b>360</b>    |

Valero was severely hurt by the pandemic in 2020-2021 and it has frozen its dividend for 9 consecutive quarters, thus putting an end to its 10-year dividend growth streak. However, the company is recovering strongly from the pandemic thanks to the aforementioned tailwinds. Moreover, Valero has a promising pipeline of growth projects for the next three years. These projects aim to lower carbon intensity and improve refining margins. We expect the refiner to grow its earnings-per-share at a 4.0% average annual rate off this year's expected level of \$6.20 per share.

## Valuation Analysis

| Year             | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | Now         | 2027        |
|------------------|------|------|------|------|------|------|------|------|------|------|-------------|-------------|
| <b>Avg. P/E</b>  | 7.2  | 9.2  | 7.5  | 7.7  | 11.9 | 14.3 | 13.8 | 14.9 | ---  | 25.5 | <b>13.2</b> | <b>10.8</b> |
| <b>Avg. Yld.</b> | 2.4% | 2.1% | 2.0% | 2.8% | 4.1% | 4.0% | 3.1% | 4.2% | 6.7% | 5.5% | <b>4.8%</b> | <b>4.8%</b> |

<sup>1</sup> In millions.

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Valero is currently trading at a forward price-to-earnings ratio of 13.2. This earnings multiple is higher than the 10-year average P/E ratio of 10.8. If the stock trades at its average valuation level in five years, it could incur a -4.0% annualized drag due to the contraction of its price-to-earnings ratio.

## Safety, Quality, Competitive Advantage, & Recession Resiliency

| Year   | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  | 2019  | 2020 | 2021 | 2022  | 2027  |
|--------|-------|-------|-------|-------|-------|-------|-------|-------|------|------|-------|-------|
| Payout | 17.3% | 19.5% | 15.3% | 21.3% | 48.6% | 56.5% | 43.4% | 63.2% | ---  | 140% | 63.2% | 52.0% |

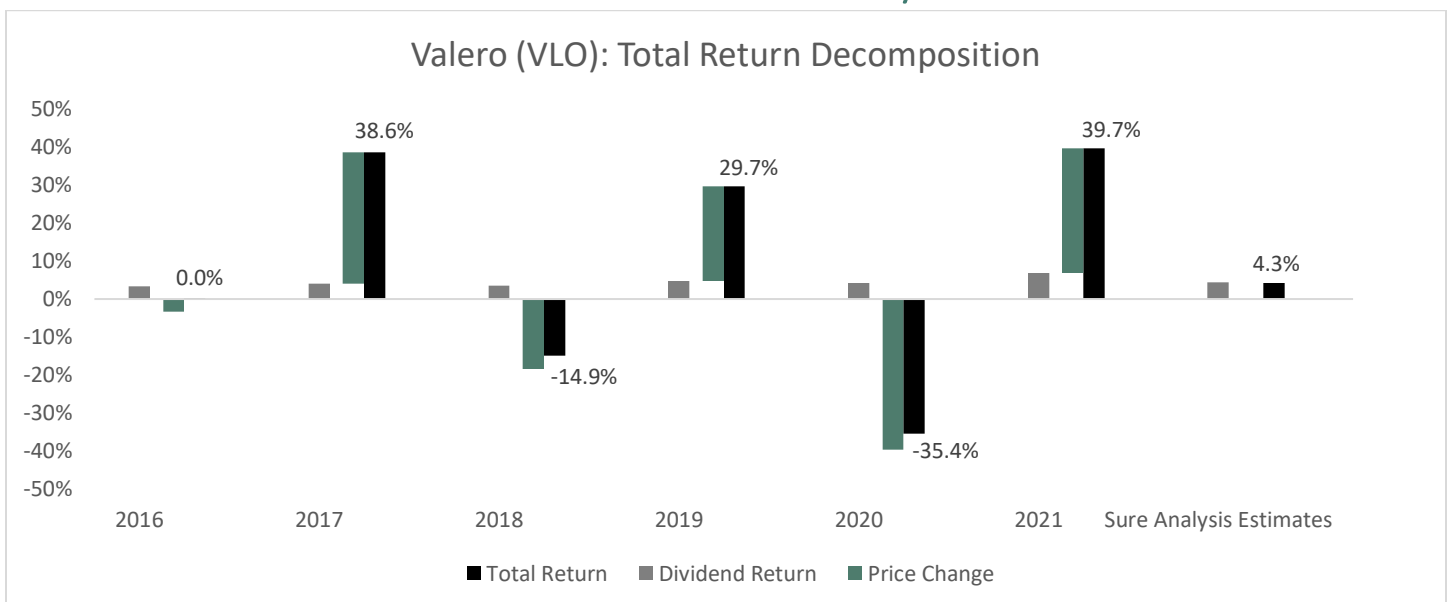
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and gasoline became cheaper than crude oil for almost three months. As a result, Valero posted operating losses. A similar picture was evident in 2020-2021 due to the pandemic, as the price of crude oil has recovered more than the prices of refined products off the bottom in 2020, thus exerting pressure on 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 takes a turn for the worse, Valero will almost certainly cut its 4.8% dividend.

## Final Thoughts & Recommendation

Valero currently enjoys multi-year high refining margins thanks to strong demand for oil products, low global inventories of light distillates and the permanent shutdown of some refineries due to the pandemic. However, the stock has rallied 40% in the last 12 months and hence it has become less attractive. We now expect Valero to offer a 4.3% average annual return over the next five years and thus we rate the stock as a hold. We also note that only patient investors, who can tolerate volatility and maintain a long-term time horizon, should consider this stock.

## Total Return Breakdown by Year



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## Income Statement Metrics

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

## Balance Sheet Metrics

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

## Profitability & Per Share Metrics

| Year                    | 2012   | 2013   | 2014   | 2015   | 2016   | 2017   | 2018   | 2019   | 2020   |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| <b>Return on Assets</b> | 4.8%   | 5.9%   | 7.8%   | 8.9%   | 5.1%   | 8.4%   | 6.2%   | 4.7%   | -2.7%  |
| <b>Return on Equity</b> | 12.1%  | 14.5%  | 18.1%  | 19.4%  | 11.3%  | 19.4%  | 14.3%  | 11.1%  | -7.0%  |
| <b>ROIC</b>             | 8.4%   | 10.5%  | 13.4%  | 14.2%  | 8.0%   | 13.4%  | 9.8%   | 7.6%   | -4.3%  |
| <b>Shares Out.</b>      | 556    | 548    | 530    | 500    | 464    | 444    | 422    | 410    | 407    |
| <b>Revenue/Share</b>    | 248.91 | 251.96 | 246.88 | 175.61 | 163.06 | 211.67 | 273.44 | 261.65 | 159.49 |
| <b>FCF/Share</b>        | 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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