



Valero Energy Corporation (VLO)

Updated January 27th, 2023 by Aristofanis Papadatos

Key Metrics

Current Price:	\$150	5 Year CAGR Estimate:	-7.0%	Market Cap:	\$55.3 B
Fair Value Price:	\$84	5 Year Growth Estimate:	0.0%	Ex-Dividend Date¹:	2/1/2023
% Fair Value:	178%	5 Year Valuation Multiple Estimate:	-10.9%	Dividend Payment Date:	3/2/2023
Dividend Yield:	2.6%	5 Year Price Target	\$84	Years Of Dividend Growth:	0
Dividend Risk Score:	D	Retirement Suitability Score:	F	Rating:	Sell

Overview & Current Events

Valero, a \$55.3 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 million 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 pandemic, which caused a collapse in oil consumption. Refining margins plunged and hence all the U.S. refiners incurred hefty losses in 2020. However, thanks to the vaccine rollout, the pandemic has subsided and global oil demand has recovered.

In late January, Valero reported (1/26/23) its financial results for the fourth quarter of fiscal 2022. The global market of refined products has become exceptionally tight due to the sanctions of western countries on Russia for its invasion in Ukraine. As a result, Valero enjoyed nearly record refining margins in the quarter and posted blowout earnings-per-share of \$8.45, which were more than 3 times the earnings-per-share of \$2.41 in the prior year's quarter. Notably, the earnings-per-share in the fourth quarter exceeded the (previous) record annual earnings-per-share of \$7.99, which were achieved in 2015. Moreover, refining margins have remained near record levels thanks to strong demand for oil products, the permanent shutdown of some refineries around the globe in the last three years due to the pandemic and tight supply due to the Ukrainian crisis. We thus expect Valero to post earnings-per-share of about \$20.00 this year. However, we expect refining margins to deflate in the upcoming years, given their highly cyclical nature.

Growth on a Per-Share Basis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
EPS	\$4.37	\$6.85	\$7.99	\$4.94	\$4.96	\$7.37	\$5.70	-\$3.12	\$2.81	\$29.16	\$20.00	\$7.80
DPS	\$0.85	\$1.05	\$1.70	\$2.40	\$2.80	\$3.20	\$3.60	\$3.92	\$3.92	\$3.92	\$3.92	\$4.12
Shares²	548	530	500	464	444	422	410	407	408	381	370	350

Valero was severely hurt by the pandemic in 2020-2021 and it has frozen its dividend for 12 consecutive quarters, thus putting an end to its 10-year dividend growth streak. However, the company is thriving right now 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. Nevertheless, as refining margins are highly cyclical, we expect flat earnings-per-share in 2028 vs. mid-cycle earnings-per-share of \$7.80.

Valuation Analysis

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	Now	2028
Avg. P/E	9.2	7.5	7.7	11.9	14.3	13.8	14.9	---	25.5	3.8	19.2	10.8
Avg. Yld.	2.1%	2.0%	2.8%	4.1%	4.0%	3.1%	4.2%	6.7%	5.5%	3.6%	2.6%	4.9%

¹ Estimated date.

² In millions.

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Valero is currently trading at 19.2 times its mid-cycle earnings-per-share of \$7.80. This earnings multiple is higher than the 10-year average price-to-earnings ratio of 10.8 of the stock. If the stock trades at its average valuation level in five years, it will incur a -10.9% annualized drag due to the contraction of its price-to-earnings ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2028
Payout	19.5%	15.3%	21.3%	48.6%	56.5%	43.4%	63.2%	---	140%	13%	50.3%	52.8%

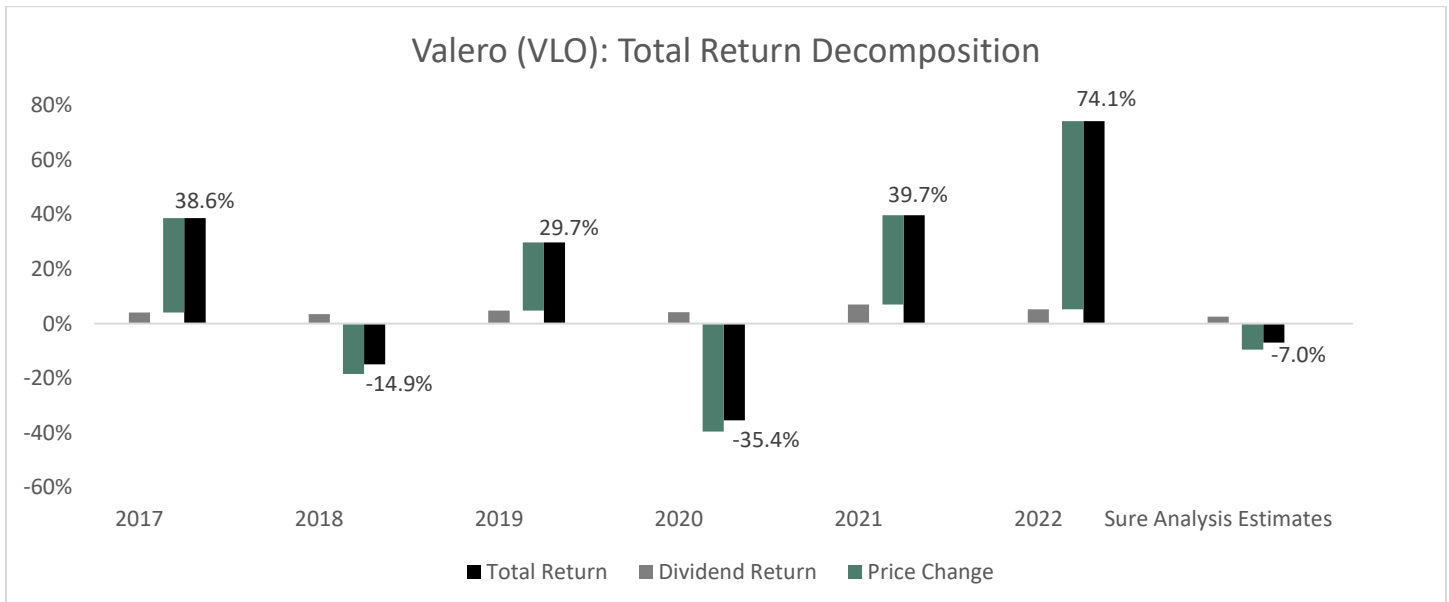
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and gasoline became cheaper than crude oil for almost three months. As a result, Valero posted operating losses. A similar picture was evident in 2020-2021 due to the pandemic, as the prices of refined products fell more than the price of crude oil, 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 and thus they all incurred material losses in 2020.

Final Thoughts & Recommendation

Valero currently enjoys blowout refining margins thanks to strong demand for oil products and low global inventories of oil products due to the war in Ukraine and the permanent shutdown of some refineries due to the pandemic. However, the stock has rallied 84% over the last 12 months and hence it has become much less attractive from a long-term perspective. Valero is thriving right now but investors should never forget the high cyclical nature of the refining business. We expect Valero to offer a -7.0% average annual return over a 5-year period, as its 2.6% dividend may be offset by a -10.9% valuation headwind, and thus we rate the stock as a sell.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Revenue (\$B)	138.39	138.07	130.84	87.80	75.66	93.98	117.03	108.3	64.9	114.0
Gross Profit	5,828	4,715	6,626	7,068	4,299	4,453	5,542	4,725	-788	3,082
Gross Margin	4.2%	3.4%	5.1%	8.0%	5.7%	4.7%	4.7%	4.4%	-1.2%	2.7%
SG&A Exp.	698	758	724	710	709	829	925	868	756	865
D&A Exp.	1,574	1,720	1,690	1,842	1,894	1,986	2,069	2,255	2,351	2,405
Operating Profit	5,130	3,957	5,902	6,358	3,590	3,563	4,572	3,836	-1,579	2,130
Operating Margin	3.7%	2.9%	4.5%	7.2%	4.7%	3.8%	3.9%	3.5%	-2.4%	1.9%
Net Profit	2,083	2,720	3,630	3,990	2,289	4,065	3,122	2,422	-1,421	930
Net Margin	1.5%	2.0%	2.8%	4.5%	3.0%	4.3%	2.7%	2.2%	-2.2%	0.8%
Free Cash Flow	2,339	3,443	2,088	3,993	3,542	4,103	2,619	3,537	-840	4,304
Income Tax	1,626	1,254	1,777	1,870	765	-949	879	702	-903	255

Balance Sheet Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Total Assets	44,477	47,260	45,550	44,227	46,173	50,158	50,155	53,864	51,774	57,888
Cash & Equivalents	1,723	4,292	3,689	4,114	4,816	5,850	2,982	2,583	3,313	4,122
Acc. Receivable	8,061	8,582	5,509	4,105	5,687	6,784	6,984	8,058	4,807	9,968
Inventories	5,973	5,758	6,623	5,898	5,709	6,384	6,532	7,013	6,038	6,265
Goodwill & Int.	213	---	154	156	148	142	567	543	508	478
Total Liabilities	26,382	27,314	24,306	22,873	25,319	27,258	27,424	31,328	32,132	38,071
Accounts Payable	9,348	9,931	6,760	4,907	6,357	8,348	8,594	10,205	6,082	12,495
Long-Term Debt	7,049	6,564	6,386	7,335	8,001	8,872	9,109	9,672	13,013	11,950
Total Equity	18,032	19,460	20,677	20,527	20,024	21,991	21,667	21,803	18,801	18,430
D/E Ratio	0.39	0.34	0.31	0.36	0.40	0.40	0.42	0.44	0.69	0.65

Profitability & Per Share Metrics

Year	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Return on Assets	4.8%	5.9%	7.8%	8.9%	5.1%	8.4%	6.2%	4.7%	-2.7%	1.7%
Return on Equity	12.1%	14.5%	18.1%	19.4%	11.3%	19.4%	14.3%	11.1%	-7.0%	5.0%
ROIC	8.4%	10.5%	13.4%	14.2%	8.0%	13.4%	9.8%	7.6%	-4.4%	2.9%
Shares Out.	556	548	530	500	464	444	422	410	407	408
Revenue/Share	248.91	251.96	246.88	175.61	163.06	211.67	273.44	261.65	159.49	280.04
FCF/Share	4.21	6.28	3.94	7.99	7.63	9.24	6.12	9.09	-1.45	10.57

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

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