



Valero Energy Corporation (VLO)

Updated January 26th, 2024 by Aristofanis Papadatos

Key Metrics

Current Price:	\$134	5 Year CAGR Estimate:	-3.3%	Market Cap:	\$45.3 B
Fair Value Price:	\$92	5 Year Growth Estimate:	0.0%	Ex-Dividend Date:	1/31/2024
% Fair Value:	146%	5 Year Valuation Multiple Estimate:	-7.3%	Dividend Payment Date:	3/4/2024
Dividend Yield:	3.2%	5 Year Price Target	\$92	Years Of Dividend Growth:	2
Dividend Risk Score:	D	Retirement Suitability Score:	D	Rating:	Sell

Overview & Current Events

Valero, a \$45.3 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 the consumption of oil products. 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 (1/25/24) its financial results for the fourth quarter of fiscal 2023. The global market of refined products has become tight due to the sanctions of western countries on Russia. In the fourth quarter, refining margins remained excessive thanks to the tight global market of refined products and thus adjusted earnings-per-share grew 4% over the prior year's quarter, from \$8.15 to \$8.45, marking the second-best quarter in the history of the company. Valero beat the analysts' consensus by \$0.60. It has not missed the analysts' estimates for 22 consecutive quarters. Management expects strong refining margins to remain in place in the current quarter thanks to extensive maintenance in many U.S. refineries. Refining margins have remained elevated for longer than expected thanks to strong demand for oil products, the permanent shutdown of some refineries around the globe since 2020 due to the pandemic and tight supply due to the Ukrainian crisis. However, we expect refining margins to deflate in the upcoming years, given their highly cyclical nature.

Growth on a Per-Share Basis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
EPS	\$6.85	\$7.99	\$4.94	\$4.96	\$7.37	\$5.70	-\$3.12	\$2.81	\$29.16	\$24.90	\$12.90	\$8.50
DPS	\$1.05	\$1.70	\$2.40	\$2.80	\$3.20	\$3.60	\$3.92	\$3.92	\$3.92	\$4.08	\$4.28	\$4.28
Shares¹	530	500	464	444	422	410	407	408	381	338	310	280

Valero was severely hurt by the pandemic in 2020-2021 and it froze its dividend for 12 consecutive quarters, thus putting an end to its 10-year dividend growth streak. However, Valero is thriving now thanks to the aforementioned tailwinds and thus it has raised its dividend by 5% this year. Moreover, it 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 2029 vs. mid-cycle earnings-per-share of \$8.50.

Valuation Analysis

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	Now	2029
Avg. P/E	7.5	7.7	11.9	14.3	13.8	14.9	---	25.5	3.8	5.1	15.8	10.8
Avg. Yld.	2.0%	2.8%	4.1%	4.0%	3.1%	4.2%	6.7%	5.5%	3.6%	3.2%	3.2%	4.7%

¹ In millions.

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Valero is currently trading at 15.8 times its mid-cycle earnings-per-share of \$8.50. 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 -7.3% annualized drag due to the contraction of its price-to-earnings ratio.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2029
Payout	15.3%	21.3%	48.6%	56.5%	43.4%	63.2%	---	140%	13%	16.4%	50.4%	50.4%

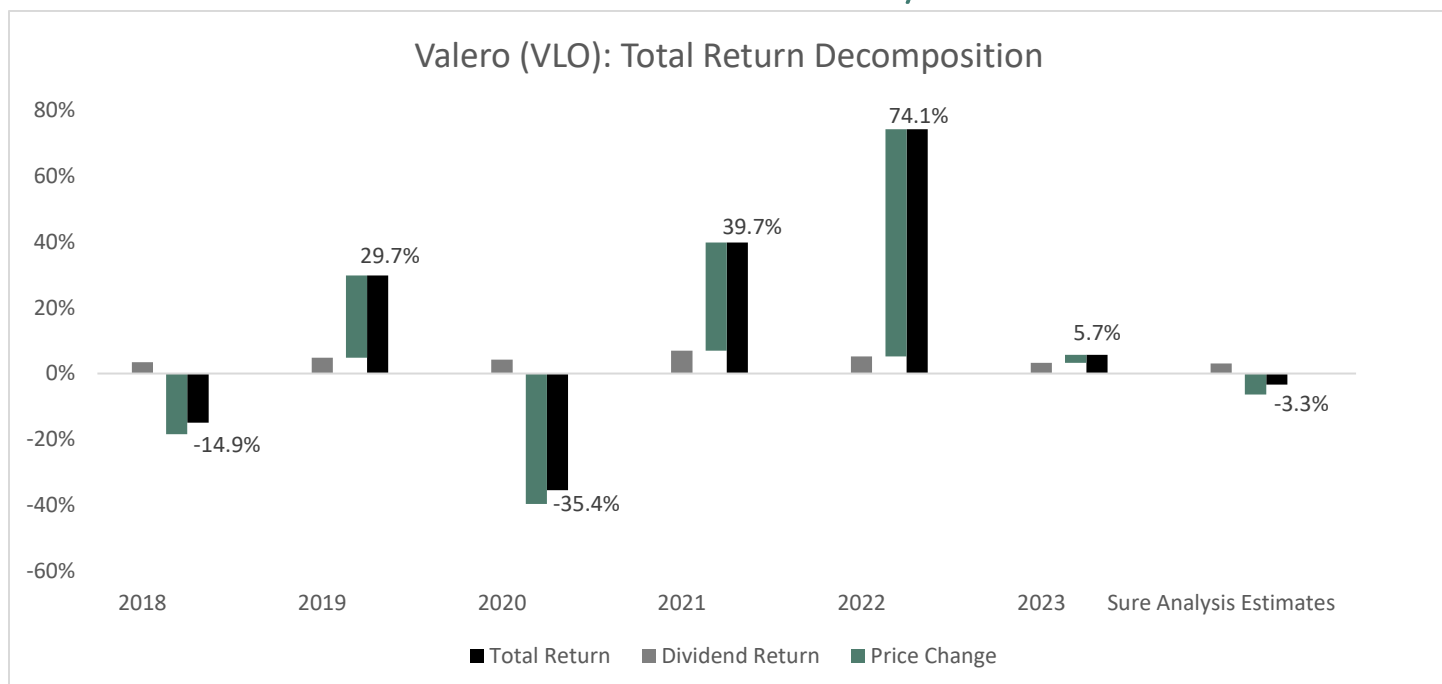
Refining is a highly cyclical business and hence all the refiners are vulnerable to declining crack spreads. Crack spreads tightened significantly during the Great Recession, when the demand for oil products greatly deteriorated and gasoline became cheaper than crude oil for almost three months. As a 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, refining is a highly cyclical business. The stock could offer a -3.3% average annual return over a 5-year period, as its 3.2% dividend may be offset by a -7.3% valuation headwind. We thus maintain our sell rating.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Revenue (\$B)	130.84	87.80	75.66	93.98	117.03	108.3	64.9	114.0	176.4	144.8
Gross Profit	6,626	7,068	4,299	4,453	5,542	4,725	-788	3,082	16,751	12,889
Gross Margin	5.1%	8.0%	5.7%	4.7%	4.7%	4.4%	-1.2%	2.7%	9.5%	8.9%
SG&A Exp.	724	710	709	829	925	868	756	865	992	998
D&A Exp.	1,690	1,842	1,894	1,986	2,069	2,255	2,351	2,405	2,473	---
Operating Profit	5,902	6,358	3,590	3,563	4,572	3,836	-1,579	2,130	15,693	11,858
Operating Margin	4.5%	7.2%	4.7%	3.8%	3.9%	3.5%	-2.4%	1.9%	8.9%	8.2%
Net Profit	3,630	3,990	2,289	4,065	3,122	2,422	-1,421	930	11,528	8,835
Net Margin	2.8%	4.5%	3.0%	4.3%	2.7%	2.2%	-2.2%	0.8%	6.5%	6.1%
Free Cash Flow	2,088	3,993	3,542	4,103	2,619	3,537	-840	4,304	10,893	---
Income Tax	1,777	1,870	765	-949	879	702	-903	255	3,428	2,619

Balance Sheet Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Total Assets	45,550	44,227	46,173	50,158	50,155	53,864	51,774	57,888	60,982	---
Cash & Equivalents	3,689	4,114	4,816	5,850	2,982	2,583	3,313	4,122	4,862	5,424
Acc. Receivable	5,509	4,105	5,687	6,784	6,984	8,058	4,807	9,968	10,761	---
Inventories	6,623	5,898	5,709	6,384	6,532	7,013	6,038	6,265	6,752	7,583
Goodwill & Int.	154	156	148	142	567	543	508	478	462	---
Total Liabilities	24,306	22,873	25,319	27,258	27,424	31,328	32,132	38,071	35,514	---
Accounts Payable	6,760	4,907	6,357	8,348	8,594	10,205	6,082	12,495	12,728	---
Long-Term Debt	6,386	7,335	8,001	8,872	9,109	9,672	13,013	11,950	9,241	---
Total Equity	20,677	20,527	20,024	21,991	21,667	21,803	18,801	18,430	23,561	26,346
D/E Ratio	0.31	0.36	0.40	0.40	0.42	0.44	0.69	0.65	0.39	---

Profitability & Per Share Metrics

Year	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Return on Assets	7.8%	8.9%	5.1%	8.4%	6.2%	4.7%	-2.7%	1.7%	19.4%	---
Return on Equity	18.1%	19.4%	11.3%	19.4%	14.3%	11.1%	-7.0%	5.0%	54.9%	35.4%
ROIC	13.4%	14.2%	8.0%	13.4%	9.8%	7.6%	-4.4%	2.9%	34.7%	28.9%
Shares Out.	530	500	464	444	422	410	407	408	396	353
Revenue/Share	246.88	175.61	163.06	211.67	273.44	261.65	159.49	280.04	445.41	410.10
FCF/Share	3.94	7.99	7.63	9.24	6.12	9.09	-1.45	10.57	27.51	---

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

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