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Jan 27, 2020

Valero Energy Corp. (VLO)

$89.26 (As of 01/24/20)

Price Target (6-12 Months): **$96.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 01/01/19) Prior Recommendation: Underperform	**Neutral**
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	**3-Hold**
	Zacks Style Scores:	VGM:B
	Value: A | Growth: B	Momentum: F

Summary

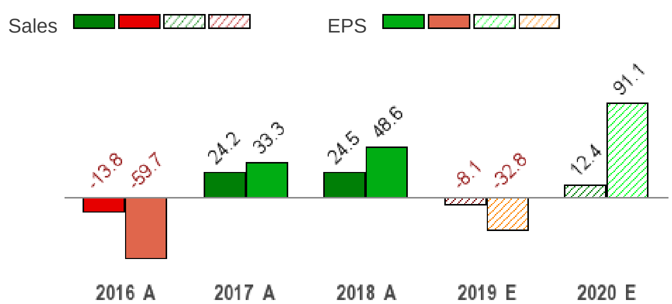
Among all independent refiners, Valero offers the most diversified refinery base with a capacity of 3.1 million barrels per day in its 15 refineries located across the United States, Canada and the Caribbean. It is now investing billions in growth projects like the Pasadena terminal, which will secure incremental earnings. Moreover, Valero is likely to benefit from rising export volumes of refined petroleum products, as the majority of its refining facilities are located in the U.S. Gulf Coast region. However, the regulatory mandate to mix enough biofuels with gasoline is a concern. Also, rising corns prices can hurt the ethanol business. Notably, as refining generates maximum earnings among all operating segments, weak refined petroleum product demand is likely to hurt its future profits. As such, the stock warrants a cautious stance.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	**$101.99 - $69.44**
20 Day Average Volume (sh)	**2,727,402**
Market Cap	**$36.7 B**
YTD Price Change	**-4.7%**
Beta	**1.46**
Dividend / Div Yld	**$3.60 / 4.0%**
Industry	**Oil and Gas - Refining and Marketing**
Zacks Industry Rank	**Top 44% (112 out of 255)**
Last EPS Surprise	**9.6%**
Last Sales Surprise	**10.8%**
EPS F1 Est- 4 week change	**-2.5%**
Expected Report Date	**01/30/2020**
Earnings ESP	**0.0%**
P/E TTM	**16.4**
P/E F1	**9.4**
PEG F1	**1.2**
P/S TTM	**0.3**

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2020	27,138 E	29,852 E	33,021 E	34,806 E	120,875 E
2019	24,263 A	28,933 A	27,249 A	27,586 E	107,554 E
2018	26,439 A	31,015 A	30,849 A	28,730 A	117,033 A

EPS Estimates

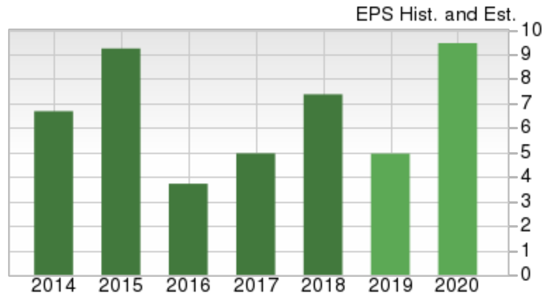
	Q1	Q2	Q3	Q4	Annual*
2020	$1.45 E	$2.86 E	$2.94 E	$2.11 E	$9.46 E
2019	$0.34 A	$1.51 A	$1.48 A	$1.60 E	$4.95 E
2018	$1.00 A	$2.15 A	$2.01 A	$2.12 A	$7.37 A

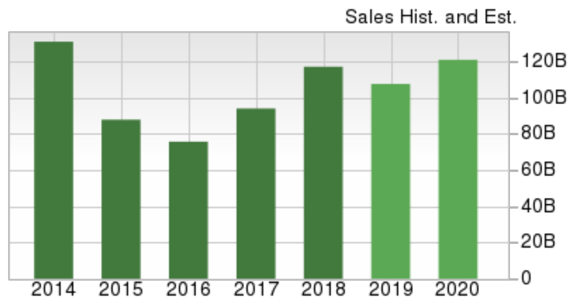
*Quarterly figures may not add up to annual.

The data in the charts and tables, including the Zacks Consensus EPS and Sales estimates, is as of 01/24/2020. The reports text is as of 01/27/2020.

Overview

San Antonio, TX-based Valero Energy Corporation is the largest independent refiner and marketer of petroleum products in the United States. The company was founded in 1980. It has a refining capacity of 3.1 million barrels per day across 15 refineries located throughout the United States, Canada and the United Kingdom.





Moreover, Valero is a leading ethanol producer with 14 ethanol plants in the Midwest that have a combined capacity of 1.73 billion gallons per year. The products of the company are sold in the markets of the United States, Canada, the United Kingdom, Ireland and Latin America. The company's brand names are carried by around 7,000 outlets.

The company organizes its business through three reportable segments, namely, Refining, Ethanol and Renewable Diesel.

- **Refining:** The Refining segment was responsible for 93% of the total margin in the third quarter of 2019. It includes refining operations, wholesale marketing, product supply and distribution, and transportation operations. This segment is segregated geographically into the Gulf Coast, mid-continent, West Coast and Northeast regions.

- **Ethanol:** The Ethanol segment includes sales of internally produced ethanol and distillers grains. Operations of this segment are geographically located in the Central Plains region of the United States. This segment was responsible for 4% of the total margin in the third quarter of 2019.

- **Renewable Diesel:** In the first quarter of 2019, the company created this segment. The Renewable Diesel segment incorporates the operations of a consolidated joint venture, Diamond Green Diesel. Notably, the renewable diesel plant is North America's largest biomass-based diesel plant and it is located in Norco, LA. The segment provided 3% of the total margin in the third quarter of 2019, which was supported by the expansion of the Diamond Green Diesel plant.

Reasons To Buy:

▲ Among all the independent refiners, Valero offers the most diversified refinery base with a capacity of 3.1 million barrels per day in its 15 refineries located throughout the United States, Canada and the Caribbean. More importantly, Valero is best placed to reap profits from solid refining margins, mainly owing to its strategic refinery structure that enables it to use cheaper oil for more than half of its needs.

Among all the independent refiners, Valero offers the most diversified refinery base.

▲ Valero has been returning funds to its shareholders on a regular basis. Through third-quarter 2019, the company returned $679 million to its shareholders, of which $3.7 million was used to repurchase 3.9 million shares of its common stock and $372 million was paid out as dividends to its stockholders. It recently increased quarterly dividend from 90 cents per share to 98 cents. Notably, Valero forecasts capital expenditure for 2019 and 2020 to be $2.5 billion each. Around 40% of the budget will be used in growth projects. The company's Pasadena terminal and St. Charles alkylation plus Pembroke cogeneration units are expected to come online in 2020. Moreover, its Diamond Green Diesel expansion and Port Arthur Coker projects are scheduled to be completed in 2021 and 2022, respectively. The growth projects are likely to boost the company's cashflow.

▲ Majority of the company's refining plants are located at the Gulf coast area from where there is an easy access to the export facilities. This Gulf coast presence helped Valero expand its export volumes over the last few years and gain from high distillate margins. Moreover, Valero is poised to benefit from the new standard set by International Maritime Organization (IMO). Per the standard, likely to be effective 2020, the proportion of sulfur in marine fuel will decline to 0.5% from the current 3.5%, thereby boosting demand for distillate fuel. Valero, being a producer of a significant amount of distillate fuel, is expected to capitalize on this.

▲ The company is projected to benefit from the rising export volumes of refined petroleum products. This is because Valero has majority of its refining facilities in the U.S. Gulf Coast region. Notably, the company entered into long-term accords to utilize three new refined product terminals in Mexico. The leading refining player will be able to expand its product supply chain once the Guadalajara, Monterrey and Altamira terminals commence operations in 2021.

Reasons To Sell:

The rising corn prices are a concern for the company.

- In a bid to lower greenhouse gas emissions, Energy Information Administration (EPA) set a Renewable Fuel Standard. Per the new mandate, refiners need to add year-over-year higher volumes of advanced biofuels to gasoline through 2019. Following this, Valero will be compelled to divert cash to ensure regulatory compliance, which can limit profitability. This is also likely to lead to the refiner incurring higher biofuel blending costs this year.
- The slowdown in the global economic growth is likely to hurt demand for refined petroleum products. This will likely affect Valero's businesses.
- Being one of the largest refiners in North America with refining contributing the most among all operating segments, weak refined petroleum products' demand is anticipated to drain the company's profit and contract total throughput volumes.
- The gasoline crack spread has significantly narrowed recently, denting the company's bottom line. Moreover, the spike in corn price has been ailing the refiner's ethanol business. In the third quarter, the company's Ethanol segment suffered an operating loss of $43 million against a profit of $21 million in the year-ago quarter due to steeper corn prices.

Last Earnings Report

Valero Energy Q3 Earnings and Revenue Beat Estimates

Quarter Ending	09/2019
Report Date	Oct 24, 2019
Sales Surprise	10.79%
EPS Surprise	9.63%
Quarterly EPS	1.48
Annual EPS (TTM)	5.45

Valero Energy posted third-quarter 2019 income of $1.48 per share, beating the Zacks Consensus Estimate of $1.35. However, quarterly earnings decreased from the year-ago figure of $2.01 per share.

Total revenues fell from $30,849 million in the prior-year period to $27,249 million in the quarter under review. However, the top line surpassed the Zacks Consensus Estimate of $24,594 million.

The better-than-expected results can be attributed to lower total cost of sales and the Diamond Green Diesel plant expansion. However, this was partially offset by narrower crude oil discounts, relative to the Brent Crude benchmark, and higher corn prices.

The company spent $525 million on Central Texas pipelines and terminals, which were completed in the reported quarter.

Segmental Performance

Operating income from the Refining segment plunged to $1,087 million from $1,424 million in the year-ago quarter. Also, the figure missed the Zacks Consensus Estimate of $1,150 million. The segment was affected by narrower crude oil discounts, relative to the Brent Crude benchmark. Notably, the company processed 190,000 barrels per day of Canadian heavy crude oil during the reported quarter.

In the Ethanol segment, the company reported operating loss of $43 million against profit of $21 million in the year-ago quarter. Moreover, the reported figure missed the Zacks Consensus Estimate of a loss of $15.9 million. The downside was caused by higher corn prices.

Valero created a new segment during the first quarter, namely Renewable Diesel, which incorporated the operations of a consolidated joint venture, Diamond Green Diesel. Gross operating income from the segment was $65 million against operating loss of $5 million in the year-ago period. The increase was attributed to the expansion of the Diamond Green Diesel plant, which had occurred in third-quarter 2018. However, the figure lagged the Zacks Consensus Estimate of $73 million.

General and administrative expenses in the Corporate and other segment totaled $217 million compared with the prior-year level of $209 million. Total cost of sales fell to $26,130 million in the quarter from the year-ago period's $29,398 million.

Throughput Volumes

During the quarter, refining throughput volumes were approximately 2,954 thousand barrels per day (MBPD), down from the prior-year quarter's 3,100 MBPD. Refinery throughput capacity utilization in the reported quarter was 94%.

In terms of feedstock composition, sweet crude, medium/light sour crude and heavy sour crude accounted for 54.7%, 8.6% and 14.2%, respectively, of its total volume. The remaining volumes came from residuals, other feedstock blendstocks and others. The Gulf Coast contributed approximately 60.2% to total throughput volume. Mid-Continent, North Atlantic and West Coast regions accounted for 15.2%, 16.1% and 9.6%, respectively.

Throughput Margins

Refining margin per barrel of throughput decreased to $9.99 from the year-ago level of $10.42. Refining operating expense per barrel was $4.05 compared with $3.72 in the year-ago quarter. Depreciation and amortization expenses increased to $1.90 a barrel from $1.68 in the prior-year quarter.

Share Repurchase

Valero returned $679 million to its shareholders, of which $3.7 million was used to repurchase around 3.9 million shares of its common stock and $372 million was paid as dividends to its shareholders.

Capital Expenditure & Balance Sheet

Third-quarter capital expenditure totaled $525 million, of which $305 million was allotted for sustaining the business.

At the end of the quarter, the company had cash and cash equivalents of $2.1 billion, and a debt of $9.6 billion. Its debt-to-capitalization ratio was 26%.

Outlook

Valero reiterated its capital expenditure view for 2019 and 2020 to be $2.5 billion each. Around 40% of the budget will be used for growth projects. The Pasadena terminal, and St. Charles alkylation and Pembroke cogeneration units are expected to come online in 2020. Moreover, the company's Diamond Green Diesel expansion and Port Arthur Coker projects are scheduled to be completed in 2021 and 2022, respectively.

Recent News

Valero Inks Deals for New Refined Product Terminals in Mexico - Nov 25, 2019

Valero Energy Corporation entered into long-term accords to utilize three new refined product terminals in Mexico. The leading refining player will be able to expand its product supply chain once the Guadalajara, Monterrey and Altamira terminals commence operations in 2021.

For the Guadalajara and Monterrey terminals, the company signed separate joint venture agreements. Precisely, Valero inked agreements with Grupo México and Silos-Tysa for the Guadalajara terminal — with expected storage capacity of 900,000 barrels. For the Monterrey terminal — likely to have a storage capacity of 425,000 barrels — the accord has been signed with Grupo México.

Investors should know that as part of the deals, Valero will not be funding the construction of the Guadalajara and Monterrey terminals. The terminals will be receiving refined products through trains and trucks, after which Valero will distribute the volumes to local and regional markets.

For constructing the Altamira terminal — with expected storage capacity of 1.1 million barrels —Operadora de Terminales Marítimas will provide funds. As part of the agreement, Valero will have access to imported refined products from the second port facility. Notably, Valero will gain access to rail services to serve the inland Mexican markets, while truck loading facilities will be employed for distributing refined products to the local market.

Valero is also constructing three additional refined product terminals in the Port of Veracruz, Puebla and Mexico City. Notably, the three terminals, for which the company entered into long-term agreements in August 2017, will commence operations in 2020.

Valero added that all the six terminals will have a combined storage capacity of 5.8 million barrels. This will help the company distribute refined product volumes to four of the largest metropolitan regions of Mexico and the country's relatively smaller fuel markets.

Valuation

Valero shares are up 10.1% in the trailing 12-month period. Over the past year, the Zacks sub-industry and the Zacks Oils-Energy sector are down 10.7% and 9%, respectively.

The S&P 500 index is up 23.8% in the past year.

The stock is currently trading at 9.48X forward 12-month Price/Earnings (P/E), which compares to 9.40X for the Zacks sub-industry, 13.67X for the Zacks sector and 18.94X for the S&P 500 index.

Over the past five years, the stock has traded as high as 19.12X and as low as 7.08X, with a 5-year median of 10.53X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $96 price target reflects 10.20X F12M earnings.

The table below shows summary valuation data for VLO.

Valuation Multiples - VLO

		Stock	Sub-Industry	Sector	S&P 500
P/E F12M	Current	9.48	9.4	13.67	18.94
	5-Year High	19.12	15.83	32.45	19.34
	5-Year Low	7.08	8.59	11.28	15.17
	5-Year Median	10.53	11.09	18.69	17.44
EV/EBITDA TTM	Current	8.14	7.02	5.03	12.38
	5-Year High	15.45	16.37	10.19	12.86
	5-Year Low	3.49	4.44	4.56	8.48
	5-Year Median	6.97	7.4	6.5	10.69
P/B TTM	Current	1.7	1.1	1.18	4.5
	5-Year High	2.34	1.83	1.59	4.55
	5-Year Low	1.02	0.95	1.02	2.85
	5-Year Median	1.48	1.28	1.31	3.62

As of 01/24/2020

Industry Analysis Zacks Industry Rank: Top 44% (112 out of 255)

Top Peers

Chevron Corporation **(CVX)**	Outperform
HollyFrontier Corporation **(HFC)**	Neutral
Marathon Petroleum Corporation **(MPC)**	Neutral
PBF Energy Inc. **(PBF)**	Neutral
Phillips 66 **(PSX)**	Neutral
Royal Dutch Shell PLC **(RDS.A)**	Neutral
BP p.l.c. **(BP)**	Underperform
Delek US Holdings, Inc. **(DK)**	Underperform

Industry Comparison Industry: Oil And Gas - Refining And Marketing

Industry Peers

	VLO Neutral	X Industry	S&P 500	MPC Neutral	PBF Neutral	PSX Neutral
VGM Score	B	-	-	A	A	A
Market Cap	36.65 B	2.62 B	24.13 B	35.38 B	3.37 B	44.58 B
# of Analysts	7	4	13	9	13	9
Dividend Yield	4.03%	0.50%	1.78%	3.89%	4.27%	3.59%
Value Score	A	-	-	A	A	A
Cash/Price	0.06	0.08	0.04	0.04	0.14	0.05
EV/EBITDA	6.45	6.63	14.02	8.99	6.80	5.72
PEG Ratio	1.18	1.54	2.03	0.68	0.88	1.54
Price/Book (P/B)	1.70	1.65	3.30	0.84	0.95	1.65
Price/Cash Flow (P/CF)	7.13	7.51	13.52	6.14	4.40	6.68
P/E (F1)	9.44	10.88	18.92	7.65	6.22	10.01
Price/Sales (P/S)	0.34	0.34	2.65	0.28	0.14	0.41
Earnings Yield	10.60%	9.11%	5.28%	13.08%	16.08%	9.99%
Debt/Equity	0.42	0.60	0.72	0.71	0.65	0.41
Cash Flow ($/share)	12.51	3.93	6.94	8.87	6.39	15.03
Growth Score	B	-	-	A	A	A
Hist. EPS Growth (3-5 yrs)	-5.51%	7.18%	10.60%	3.48%	-13.95%	9.90%
Proj. EPS Growth (F1/F0)	91.07%	23.10%	7.59%	71.73%	463.01%	23.10%
Curr. Cash Flow Growth	24.76%	14.29%	13.90%	48.56%	78.06%	91.99%
Hist. Cash Flow Growth (3-5 yrs)	4.78%	9.89%	9.00%	12.55%	23.93%	8.47%
Current Ratio	1.40	1.29	1.22	1.25	1.56	1.29
Debt/Capital	29.81%	38.51%	42.99%	42.25%	39.46%	29.03%
Net Margin	2.12%	1.93%	11.35%	2.50%	-0.36%	4.17%
Return on Equity	10.37%	9.34%	17.10%	8.94%	4.77%	19.31%
Sales/Assets	2.13	1.68	0.55	1.31	2.81	1.92
Proj. Sales Growth (F1/F0)	12.39%	7.08%	4.03%	9.14%	7.97%	13.44%
Momentum Score	F	-	-	F	A	F
Daily Price Chg	-0.28%	-0.28%	-1.01%	-1.52%	-2.63%	-1.72%
1 Week Price Chg	-5.85%	-3.23%	2.29%	-5.53%	-7.60%	-1.49%
4 Week Price Chg	-5.46%	-8.93%	1.02%	-9.89%	-10.88%	-10.48%
12 Week Price Chg	-7.96%	-12.16%	6.85%	-14.79%	-12.92%	-14.12%
52 Week Price Chg	13.06%	-0.69%	20.39%	-13.66%	-18.57%	9.84%
20 Day Average Volume	2,727,402	643,939	1,536,379	5,073,110	1,280,156	2,225,091
(F1) EPS Est 1 week change	-0.72%	0.00%	0.00%	0.00%	4.90%	0.00%
(F1) EPS Est 4 week change	-2.46%	-2.46%	0.00%	-6.74%	1.28%	-5.31%
(F1) EPS Est 12 week change	-0.16%	-2.07%	-0.23%	-2.07%	-1.55%	-5.48%
(Q1) EPS Est Mthly Chg	-11.82%	-9.19%	0.00%	-14.59%	-52.99%	-9.19%

Zacks Stock Rating System

We offer two rating systems that take into account investors' holding horizons: Zacks Rank and Zacks Recommendation. Each provides valuable insights into the future profitability of the stock and can be used separately or in combination with each other depending on your investment style.

Zacks Recommendation

The Zacks Recommendation aims to predict performance over the next 6 to 12 months. The foundation for the quantitatively determined Zacks Recommendation is trends in the company's estimate revisions and earnings outlook. The Zacks Recommendation is broken down into 3 Levels; Outperform, Neutral and Underperform. Unlike many Wall Street firms, we have an excellent balance between the number of Outperform and Neutral recommendations. Our team of 70 analysts are fully versed in the benefits of earnings estimate revisions and how that is harnessed through the Zacks quantitative rating system. But we have given our analysts the ability to override the Zacks Recommendation for the 1200 stocks that they follow. The reason for the analyst over-rides is that there are often factors such as valuation, industry conditions and management effectiveness that a trained investment professional can spot better than a quantitative model.

Zacks Rank

The Zacks Rank is our short-term rating system that is most effective over the one- to three-month holding horizon. The underlying driver for the quantitatively-determined Zacks Rank is the same as the Zacks Recommendation, and reflects trends in earnings estimate revisions.

Zacks Style Scores

The Zacks Style Score is as a complementary indicator to the Zacks rating system, giving investors a way to focus on the highest rated stocks that best fit their own stock picking preferences.

Academic research has proven that stocks with the best Value, Growth and Momentum characteristics outperform the market. The Zacks Style Scores rate stocks on each of these individual styles and assigns a rating of A, B, C, D and F. We also produce the VGM Score (V for Value, G for Growth and M for Momentum), which combines the weighted average of the individual Style Scores into one score. This is perfectly suited for those who want their stocks to have the best scores across the board.

Value Score	A
Growth Score	B
Momentum Score	F
VGM Score	B

As an investor, you want to buy stocks with the highest probability of success. That means buying stocks with a Zacks Recommendation of Outperform, which also has a Style Score of an A or a B.

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