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Aug 27, 2020

Valero Energy Corp. (VLO)

$53.70 (As of 08/26/20)

Price Target (6-12 Months): **$57.00**

Long Term: 6-12 Months	**Zacks Recommendation:** (Since: 04/14/20) Prior Recommendation: Underperform	Neutral
Short Term: 1-3 Months	**Zacks Rank:** (1-5)	4-Sell
	Zacks Style Scores:	VGM:A
	Value: A | Growth: B | Momentum: F	

Summary

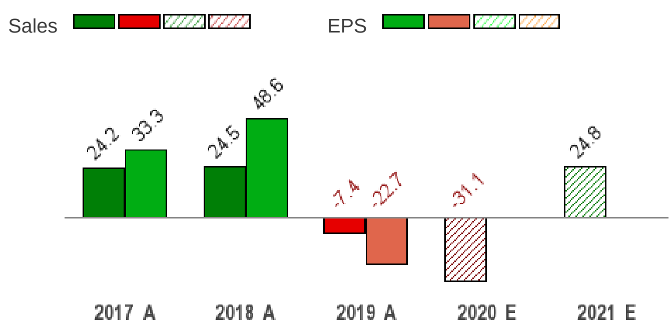
Valero is poised to benefit from the new standard set by International Maritime Organization. The company being a producer of a significant amount of distillate fuel, will capitalize on this. Importantly, it has completed the Pasadena terminal project, which will boost export flexibility. Moreover, Valero has been returning funds to its shareholders on a regular basis. The company recently reported narrower-than-expected loss owing to a rise in renewable diesel sales volumes. This was, however, partially offset by lower ethanol prices.Importantly, although the refiner's cash balance can clear short-term debt of only $587 million, the coronavirus-induced dented fuel demand has raised questions on the company's ability to pay off a portion of its long-term debt load of $12.1 billion, that are due for repayment after 12 months.

Price, Consensus & Surprise

Data Overview

52 Week High-Low	$101.99 - $31.00
20 Day Average Volume (sh)	4,148,157
Market Cap	$21.9 B
YTD Price Change	-42.7%
Beta	1.90
Dividend / Div Yld	$3.92 / 7.3%
Industry	Oil and Gas - Refining and Marketing
Zacks Industry Rank	Bottom 32% (172 out of 252)
Last EPS Surprise	12.0%
Last Sales Surprise	-34.2%
EPS F1 Est- 4 week change	-23.4%
Expected Report Date	10/22/2020
Earnings ESP	-28.1%
P/E TTM	19.9
P/E F1	NA
PEG F1	NA
P/S TTM	0.3

Sales and EPS Growth Rates (Y/Y %)



Sales Estimates (millions of $)

	Q1	Q2	Q3	Q4	Annual*
2021	22,290 E	25,103 E	26,288 E	28,302 E	93,093 E
2020	22,102 A	10,397 A	18,485 E	22,970 E	74,606 E
2019	24,263 A	28,933 A	27,249 A	27,879 A	108,324 A

EPS Estimates

	Q1	Q2	Q3	Q4	Annual*
2021	$0.13 E	$0.97 E	$1.38 E	$0.79 E	$3.18 E
2020	$0.34 A	-$1.25 A	-$0.60 E	-$0.43 E	-$2.06 E
2019	$0.34 A	$1.51 A	$1.48 A	$2.13 A	$5.70 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 08/26/2020. The reports text is as of 08/27/2020.

Overview

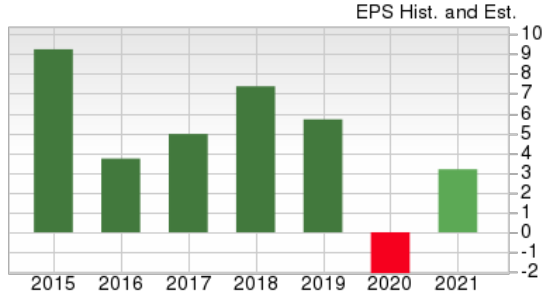
San Antonio, TX-based Valero Energy Corporation is the largest independent refiner and marketer of petroleum products in the United States. The company was founded in 1980. It has a refining capacity of 3.1 million barrels per day across 15 refineries located throughout the United States, Canada and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

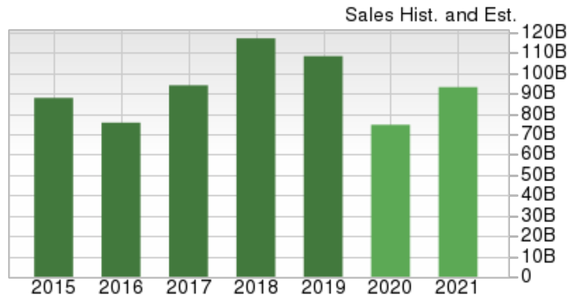
Moreover, Valero is a leading ethanol producer with 14 ethanol plants in the Midwest that have a combined capacity of 1.73 billion gallons per year. The products of the company are sold in the markets of the United States, Canada, the United Kingdom, Ireland and Latin America. The company's brand names 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 84% of the total margin in 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 less than 1% of the total margin in 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 15% of the total margin in 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. Notably, through the June quarter, the leading independent refiner and marketer of petroleum products has returned $400 million to stockholders as dividend payments.

▲ 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. Additionally, in first-quarter 2020, the company completed the Pasadena terminal project, which will likely expand the product logistics portfolio, enhance capacity for biofuels blending and boost export flexibility.

▲ Moreover, Valero is poised to benefit from the new standard set by International Maritime Organization (IMO). Per the standard, which was effective since January 2020, the proportion of sulfur in marine fuel has declined 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.

▲ Once the coronavirus pandemic gets under control, the company is projected to benefit from 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 firm's weak refining business is concerning.

- 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. Following this, Valero is 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 current market uncertainty caused by coronavirus-induced lockdowns and strict social distancing measures has reduced demand for the company's products like gasoline and jet fuel. Weak energy demand environment has been denting the company's refining business.
- Weak refining throughput volumes are affecting the company's refining segment, its biggest business unit. Also, lower ethanol prices are hurting its ethanol segment's profit levels. Given the current market uncertainty, the situation is not expected to improve anytime soon.
- At the end of the second quarter, the company had cash and cash equivalents of $2.3 billion. Although the cash balance can clear short-term debt of only $587 million, the coronavirus-induced dented fuel demand has raised questions on the company's ability to pay off a portion of its long-term debt load of $12.1 billion, that are due for repayment after 12 months.
- The company has also decided to defer some capital projects, associated to its refining and ethanol segments, which were planned for this year.

Last Earnings Report

Valero Energy Q2 Earnings Beat Estimates, Revenues Miss

Quarter Ending	06/2020
Report Date	**Jul 30, 2020**
Sales Surprise	**-34.22%**
EPS Surprise	**11.97%**
Quarterly EPS	**-1.25**
Annual EPS (TTM)	**2.70**

Valero Energyreported second-quarter 2020 loss of $1.25 per share, narrower than the Zacks Consensus Estimate of a loss of $1.42. In the year-ago quarter, the company reported earnings of $1.51 per share.

Total revenues fell from $28,933 million in the prior-year period to $10,397 million. Moreover, the top line missed the Zacks Consensus Estimate of $15,806 million.

The narrower-than-expected loss can be attributed to a rise in renewable diesel sales volumes and speedy recovery in refined product demand. This was partially offset by lower ethanol prices.

Segmental Performance

Operating income at the **Refining** segment was reported at $1,751 million, suggesting an increase from $1,037 million in the year-ago quarter. Speedy recovery in refined product demand despite the coronavirus pandemic aided the segment.

In the **Ethanol** segment, the company reported operating profit of $91 million, reflecting a jump from $7 million in the second quarter of 2019. The upside was led by a significant decline in total cost of sales, offset partially by lower ethanol prices and throughput.

Operating income at the **Renewable Diesel** segment increased to $129 million from $77 million in the year-ago period on a rise in renewable diesel sales volumes.

Throughput Volumes

During the quarter, refining throughput volumes were 2,321 thousand barrels per day (Mbpd), down from the prior-year quarter's 2,968 Mbpd.

In terms of feedstock composition, sweet crude, medium/light sour crude and heavy sour crude accounted for 43.9%, 16.6% and 16.3%, respectively, of its total volume. The remaining volumes came from residuals, other feedstock and; blendstocks and others.

The Gulf Coast contributed approximately 59.7% to total throughput volume. Mid-Continent, North Atlantic and West Coast regions accounted for 15.7%, 14.6% and 10%, respectively, of the total throughput volume.

Throughput Margins

Refining margin per barrel of throughput decreased to $5.10 from the year-ago level of $9.58. Refining operating expense per barrel was $4.39 compared with $3.8 in the year-ago quarter. Depreciation and amortization expenses increased to $2.53 a barrel from $1.92 in the prior-year quarter. As such, adjusted refining operating loss was recorded at $1.82 per barrel of throughput against the year-ago profit of $3.86.

Capital Investment & Balance Sheet

Second-quarter capital investment totaled $503 million. Of the total amount, $240 million was allotted for sustaining the business. Notably, through the June quarter, the leading independent refiner and marketer of petroleum products has returned $400 million to stockholders as dividend payments.

At the end of the quarter, the company had cash and cash equivalents of $2,319 million. As of Jun 30, 2020, it had a total debt of $12,677 million. Its debt-to-capitalization was 39%.

Valuation

Valero shares are down 42.7% in the year-to-date period, and 26.2% over the trailing 12-month period. Stocks in the Zacks sub-industry and Zacks Oils-Energy sector are down 38.7% and 37.8%, respectively, in the year-to-date period. Over the past year, the Zacks sub-industry and sector are down 33.9% and 41.2%, respectively.

The S&P 500 index is up 8.1% in the year-to-date period and 20.9% in the past year.

The stock is currently trading at 0.25X forward 12-month Price/sales, which compares to 0.25X for the Zacks sub-industry, 0.71X for the Zacks sector and 3.81X for the S&P 500 index.

Over the past five years, the stock has traded as high as 0.52X and as low as 0.12X, with a 5-year median of 0.32X. Our Neutral recommendation indicates that the stock will perform in-line with the market. Our $57 price target reflects 0.35X F12M sales.

The table below shows summary valuation data for VLO.

Valuation Multiples - VLO

		Stock	Sub-Industry	Sector	S&P 500
P/S F12M	Current	0.25	0.25	0.71	3.81
	5-Year High	0.52	0.37	1.47	3.81
	5-Year Low	0.12	0.17	0.59	2.53
	5-Year Median	0.32	0.29	0.99	3.05
EV/EBITDA TTM	Current	5.04	9.65	4.3	13.25
	5-Year High	15.52	16.48	10.48	13.25
	5-Year Low	2.03	4.31	3.05	8.25
	5-Year Median	6.92	7.43	6.47	10.92
P/B TTM	Current	1.06	0.84	1.04	4.71
	5-Year High	2.34	1.83	1.55	4.71
	5-Year Low	0.59	0.42	0.52	2.83
	5-Year Median	1.47	1.23	1.32	3.76

As of 08/26/2020

Industry Analysis **Zacks Industry Rank:** Bottom 32% (172 out of 252)

Top Peers

Company (Ticker)	Rec	Rank
Royal Dutch Shell PLC **(RDS.A)**	Outperform	2
BP p.l.c. **(BP)**	Neutral	4
Chevron Corporation **(CVX)**	Neutral	3
Delek US Holdings, Inc. **(DK)**	Neutral	4
HollyFrontier Corporation **(HFC)**	Neutral	3
Marathon Petroleum Corporation **(MPC)**	Neutral	4
PBF Energy Inc. **(PBF)**	Neutral	4
Phillips 66 **(PSX)**	Neutral	4

Industry Comparison Industry: Oil And Gas - Refining And Marketing

Industry Peers

	VLO	X Industry	S&P 500	MPC	PBF	PSX
Zacks Recommendation (Long Term)	Neutral	-	-	Neutral	Neutral	Neutral
Zacks Rank (Short Term)	4	-	-	4	4	4
VGM Score	A	-	-	A	B	B
Market Cap	21.90 B	1.31 B	23.69 B	22.99 B	1.10 B	26.21 B
# of Analysts	9	4	14	9	8	9
Dividend Yield	7.30%	0.00%	1.65%	6.57%	0.00%	6.00%
Value Score	A	-	-	A	A	B
Cash/Price	0.11	0.28	0.07	0.05	1.18	0.07
EV/EBITDA	5.11	4.54	13.37	6.77	3.95	6.16
PEG Ratio	NA	7.94	3.04	NA	NA	12.37
Price/Book (P/B)	1.06	1.06	3.17	0.75	0.38	1.13
Price/Cash Flow (P/CF)	4.76	3.90	12.78	3.30	1.96	5.31
P/E (F1)	NA	16.87	21.63	NA	NA	64.32
Price/Sales (P/S)	0.25	0.29	2.50	0.23	0.05	0.29
Earnings Yield	-3.93%	-5.27%	4.44%	-8.75%	-84.21%	1.55%
Debt/Equity	0.59	1.05	0.75	1.05	1.53	0.54
Cash Flow ($/share)	11.28	4.65	6.94	10.70	4.65	11.30
Growth Score	B	-	-	B	D	B
Hist. EPS Growth (3-5 yrs)	-6.80%	13.95%	10.41%	3.82%	-3.33%	14.62%
Proj. EPS Growth (F1/F0)	-136.96%	-88.55%	-4.92%	-162.53%	-953.20%	-88.41%
Curr. Cash Flow Growth	-11.67%	2.05%	5.22%	13.40%	-27.27%	-27.54%
Hist. Cash Flow Growth (3-5 yrs)	-2.48%	6.45%	8.50%	12.38%	-2.24%	0.90%
Current Ratio	1.75	1.44	1.34	1.27	1.66	1.25
Debt/Capital	36.94%	51.89%	44.18%	51.89%	60.47%	35.22%
Net Margin	1.22%	-1.32%	10.25%	-7.55%	-2.70%	-1.32%
Return on Equity	5.30%	5.30%	14.66%	3.04%	-11.97%	8.76%
Sales/Assets	1.74	1.26	0.50	1.11	2.20	1.59
Proj. Sales Growth (F1/F0)	-31.21%	-31.03%	-1.45%	-39.67%	-29.96%	-32.31%
Momentum Score	F	-	-	D	F	F
Daily Price Chg	-1.01%	-1.33%	-0.18%	-3.07%	-0.55%	-2.60%
1 Week Price Chg	-3.38%	-4.06%	-1.45%	-7.69%	-7.98%	-4.23%
4 Week Price Chg	-10.04%	0.00%	2.10%	-11.48%	3.05%	-8.46%
12 Week Price Chg	-23.87%	-13.25%	3.61%	-8.45%	-23.10%	-28.31%
52 Week Price Chg	-26.20%	-38.90%	3.61%	-23.74%	-59.82%	-37.58%
20 Day Average Volume	4,148,157	641,257	1,883,291	8,391,608	3,889,010	3,294,704
(F1) EPS Est 1 week change	-6.04%	0.00%	0.00%	-4.12%	-0.69%	-13.04%
(F1) EPS Est 4 week change	-23.36%	-5.11%	0.93%	-11.92%	-7.92%	-48.96%
(F1) EPS Est 12 week change	-33.62%	-29.18%	3.41%	-45.55%	-29.18%	-59.16%
(Q1) EPS Est Mthly Chg	-55.94%	-33.43%	0.00%	-62.46%	-39.55%	-54.04%

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	A

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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