BofA SECURITIES

Valero Energy Corp.

4Q23 First look: strong beat vs lowered consensus. Strong ops, syncrude discount

Maintain Rating: NEUTRAL | PO: 156.00 USD | Price: 130.15 USD

Strong beat on lowered consensus

Adjusted EPS of $3.55 beat BofA and consensus of $2.92 / $2.94, which had fallen sharply from ~$3.90 during management discussions after a tough Dec tape. Vs our estimate, the beat was stronger Atlantic Basin margins - $20.36/bbl (vs our est. of $15.05) which looks entirely on wide Syncrude pricing which represents most of VLO's Quebec refinery runs and ~50% of its Atlantic segment. Still, the beat underlines VLO's operational capacity to take advantage of dislocations: Syncrude traded at a $10-$20 discount to Brent for 2 out of 3 months vs a more normal premium. Cash flow (excluding w/c) was $1.86bn was within sight of consensus ($1.8bn), and easily covered capex ($560mm) and leaving underlying free cashflow of $1.2bn. VLO returned $1.34bn to shareholders ($966mm buyback), lifting its FY payout to 60% vs a target of 40%-50%. After a seasonal working capital build of $631mm, free cashflow of $516mn means management used its b/sheet to maintain a strong commitment to shareholder returns. With net debt / cap at 18% vs a target of 20% - 30%, this may have further to go.

Syncrude 'gap' drives better refining (still wide in 1Q)

Strong operational reliability is a hallmark of VLO and is on display again in 4Q. Average company wide margins of $12.89/bbl beat BofA / consensus of $12.18 / $11.91. Throughput was again at the top half of guidance (2,995 vs 2,930-3,040 mmbd) driving a strong refining quarter ($1.6bn vs $1.47bn BofA). As mentioned above, we see the beat concentrated in the Atlantic Basin, where margin capture of 127% compared with a seasonal long-term average of 103%. Heat cracks remained solid vs 3Q23 leaving the strong beat on Syncrude discounts at Quebec. Syncrude's 'normal' quality premium reversed sharply in November to a $7/bbl discount, presumably as egress in Canada tightened with volumes growing ahead of the startup of TMX, which secured its route variation earlier in January with expected end of quarter start: look for color on the call on how long this persists. Otherwise we see Gulf Coast in-line with our estimate (60% of earnings, $11.69 vs $11.61 expected) with sequential margin capture improvement (83% vs 74% q/q) on seasonal tailwinds from butane blending. All regions except for the Atlantic Basin were at the top of throughput guidance (452 vs 470-490mbd).

Reliability matters: payout can remain elevated

In our view, the key takeaway from 4Q23 is that reliability matters - while the Syncrude benefit was significant in 4Q23, we expect it to persist through 1Q24 or until line fill for the Transmountain expansion continues. At current margins, this means shareholder returns can also remain elevated, perhaps until such times that VLO acknowledges a higher mid cycle as a new normal. However even at our long-term base case (GC 321 Brent $11.50) we believe VLO can maintain its payout above its plan – with 70% of cash flow available after a $2bn capital program and with no change in net debt which remains below its target range (18% vs 20-30%). With an implied normalized FcF yield of ~10%, we believe fair value at a sector average cost of capital is reasonably $156 PO – similar upside potential to the generic E&P sector but with perhaps a more resilient margin outlook.

Refer to important disclosures on page 3 to 5. Analyst Certification on page 2. Price Objective Basis/Risk on page 2. 12650747

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Equity

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Stock Data

Price	130.15 USD
Price Objective	156.00 USD
Date Established	5-Jan-2024
Investment Opinion	C-2-7
52-Week Range	104.18 USD - 152.20 USD
Mrkt Val (mn) / Shares Out (mn)	52,971 USD / 407.0
Free Float	99.5%
Average Daily Value (mn)	407.71 USD
BofA Ticker / Exchange	VLO / NYS
Bloomberg / Reuters	VLO US / VLO.N
ROE (2023E)	36.4%
Net Dbt to Eqty (Dec-2022A)	26.6%
ESGMeter™	High

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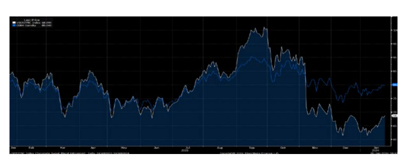
TMX – Transmountain expansion
GC – Gulf Coast

Exhibit 1: Syncrude vs Brent
Wide 'gap' in 4Q23 has continued into 2024



Source: Bloomberg

4Q23 earnings summary

The table below summarizes actual 4Q23 earnings vs estimates and prior quarterly and year over year results.

Exhibit 1: VLO Earnings Variance

Q/Q and Y/Y Comparision (all figures in $ millions, except per share)

	4Q23	4Q23	3Q23	Q/Q	4Q22	Y/Y
Refining	1,577	1,474	3,451	-57%	4,355	-66%
Ethanol	190	198	197	1%	69	187%
Renewable Diesel	81	76	123	-38%	261	-71%
Total Segment EBT	**1,848**	**1,749**	**3,771**	**-54%**	**4,685**	**-63%**
Items not allocated to segments						
Corporate & other unallocated items	(295)	(255)	(250)	-2%	(303)	16%
Income from Operations	**1,553**	**1,494**	**3,521**	**-58%**	**4,382**	**-66%**
Net Interest Expense	(149)	(145)	(149)	3%	(137)	-6%
Earnings Before Tax	**1,404**	**1,349**	**3,372**	**-60%**	**4,245**	**-68%**
Income Tax Expense	(331)	(313)	(813)	62%	(1,018)	69%
Tax rate	24%	23%	24%	-4%	24%	-3%
Income (loss) from continuing ops.	1,218	1,036	2,663	-61%	3,339	-69%
Add Income (loss) from discontinued ops.	-	-	-		-	
Net Income (loss)	1,218	1,036	2,663	-61%	3,339	-69%
Less income attributable to NCI	16	28	41	-31%	119	-76%
Adjusted Net Income to VLO	**1,202**	**1,008**	**2,622**	**-62%**	**3,220**	**-69%**
Adjusted EPS	$3.56	$2.92	$7.51	-61%	$8.45	-65%

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Price objective basis & risk

Valero Energy Corp. (VLO)

Our price objective of $156/share is based on an assessed DCF value by treating the assets as annuities after deducting maintenance capital. We use a long term Gulf Coast 321 crack spread in our benchmark assumptions of $11.50/bbl, a long-term crude differential of $3.5 and a WACC of 9.25%, a zero terminal growth rate, and a 22% corporate tax rate.

Downside risks to our price objective are: (1) the company is heavily weighted toward sour crude. As light-heavy crude differentials narrow, the benefits of a more complex refinery will diminish, which may delay return on investment, (2) the company is vulnerable to refining margin correction. If demand for refined products is weaker than expected, or if oil prices remain robust, this could pressure margins, (3) the inability to capture the price environment due to cost pressures (opex, capex, and taxation), (4) tax reform is not passed.

Upside risks to our price objective are: (1) higher-than-expected crack spreads, and (2) stronger-than-expected gasoline demand.

Analyst Certification

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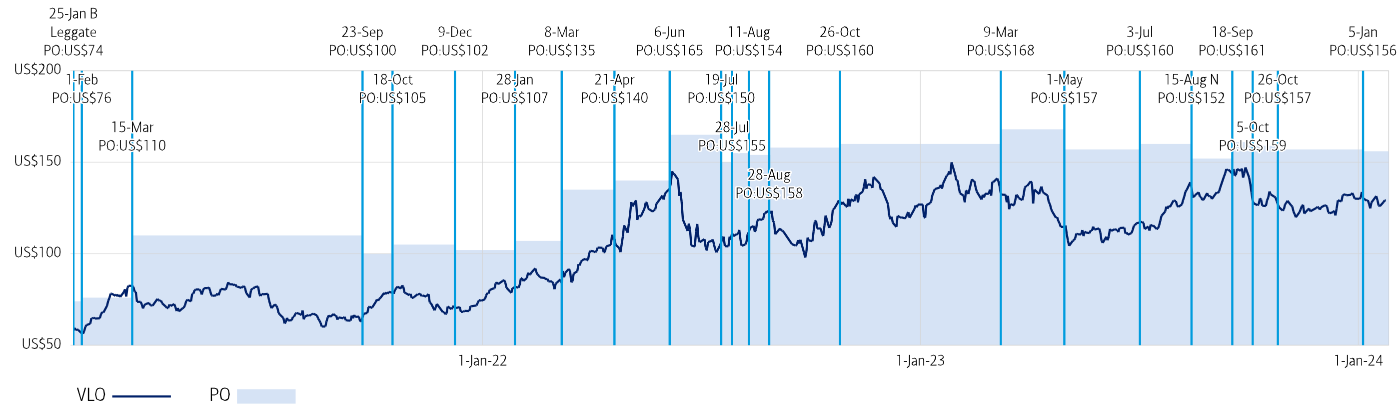
Valero (VLO) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	83	61.48%	Buy	64	77.11%
Hold	28	20.74%	Hold	21	75.00%
Sell	24	17.78%	Sell	18	75.00%

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Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
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Sell	807	22.84%	Sell	383	47.46%

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