南山人壽

Valero Energy Corporation (NYSE:VLO)

Pitch Deck, April-26-2020

Hsuan (Annie) Liu

南山人壽

Outline

Valero Energy Corporation

(1) Source: Retrieved from https://www.valero.com/en-us & https://www.nanshanlife.com.tw/NanshanWeb/

Executive Summary

Investment Profile & Share Performance

Investment Highlights

- I give VLO a **BUY** rating with a **12-month target price of $110**, representing an **implied upside of 111%**

Acquisitions

- A primary growth factor in VLO's long term growth
- The most recent deal of Ethanol Plants is expected to increase production capacity of 280M gallons/year; Peru Acquisition is expected to increase 1M barrels of storage capacity

Strong Governance and Quality Growth

- Stable growth from 2015 with increased production and distinctive free cash flow
- Disciplined capital investment and growth strategy with approx. $2.5B annual capex for product expansion incl. renewable energy and pipeline to Mexico and Latin America

High ROE and dividend yield

- The increase in technology proficiency and consistent operations allows VLO to remain relatively high ROE and dividend yield, which is in favor of Nanshan's investment goal to create a stable and growing investment return simultaneously

Market Profile (04/24/20)

52 Week Range	$31.00 - $101.99
Avg Daily Vol (3 Mo)	5,943,863
Basic Shares Outstanding (M)	408.5
Market Capitalization (M)	21,273
Enterprise Value (M)	28,900
52 Week Beta	1.72
EPS (FY19)	5.85
P/E (ttm)	8.91
Dividend Yield	7.5%
Return on Assets (ttm)	4.67%
Return on Equity (ttm)	12.30%

Share Performance

(1) Source: MD&A Report, (2) Source: FactSet

南山人壽

Company Analysis

Business Overview

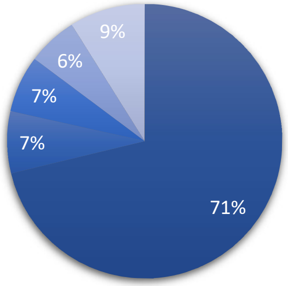
Business Description

- Valero Energy Corp. engages in the manufacture and marketing of transportation fuels and other petrochemical products. Business segments includes Refining, Ethanol and Renewable Diesel.
- Valero has 15 refineries, 3.2 M barrels per day of capacity, 3.1k miles of active pipelines, 130M storage, 50 docks
- Valero has 14 Ethanol plants with 1.73B gallons of capacity per year
- World's 2nd largest renewable diesel producer with 675M gallons of capacity per year

Management & Governance

- J.W. Gorder holds the position of Chairman and Chief Executive Officer and has served the firm since 2003
- D.M. Titzman, current Vice President and CFO, joined Valero in 1986
- Valero is well-known in safety and reliability production. Its governance guidelines drive Valero's disciplined capex and become lowest cost producer

Revenue Breakdown by Region



Major Events

1. China-US Trade War negatively influenced the global demand and company's cost structure
2. Valero completed its acquisition of all of the outstanding publicly held common units of VLP in Jan. 2019
3. Adverse impacts from Covid-19 and Oil Price Crash

(1) Source: Company 10K, (2) Source: FactSet

Industry Analysis

U.S. Petroleum Refining Overview

Industry Summary

Industry Performance	• Pre-Covid19: Petroleum Refining Industry revenue in the United States is expected to grow at 1.1 % CAGR to 2024 • Post-Covid19: Decreasing demand and oversupply of crude oil are expected to decrease US industry revenue by 2%; gradually recovered beyond 2021
Outlook	• Tough environmental regulations limit new refinery development • Renewable fuel mandates will take more market share • Fuel-efficient vehicles will likely limit downstream revenue growth

Core Drivers

World price of crude oil

- Primary cost driver, decreased price of crude oil creates stable profit margin of refining industry

Demand from gasoline and petroleum bulks stations

- The gasoline and petroleum bulk stations industry is anticipated to decrease. Lower demand results in declining industry revenue.

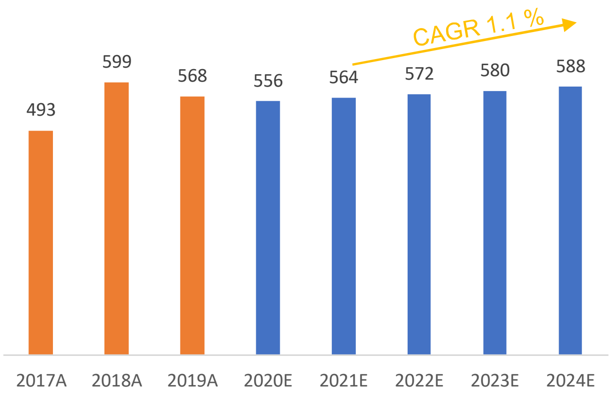
Global GDP

- Crude oil consumption is positively related to worldwide GDP growth and growth of human and vehicle population

Trade-weighted index

- When TWI decreases, US-made refined petroleum product becomes more affordable

Historical & Projected US Industry Sales (USD Billions)

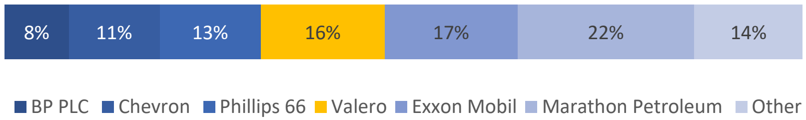


U.S. Industry Structure

Industry revenue $567.5 B USD

Industry profit $24.4 B USD

- Mature Life Cycle Stage
- High Capital Intensity
- Medium Concentration Level
- High Barriers to Entry

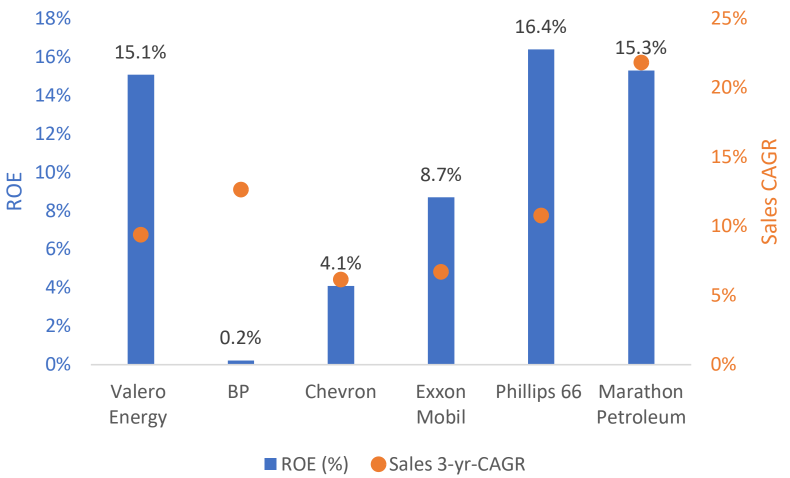


(1) Source: IBIS World, (2) Source: FactSet

Competitive Review

Trading Comparable Analysis

Select Peer Comparable Analysis



Valero Core Competencies

One of the Leading Independent Refiner and Largest Renewable Fuels Producer in NA

- Specializing in converting lower-cost crude oil into refined fuels and petroleum products – a sustainable market
- Diversified product portfolio, 86 different crude oils, making it an industry leader

Competitive Refining Operating Expenses per Barrel

- $4 per barrel whereas $4 -$6.5 for peer range (20% lower on average)
- Its refining business benefited from processing sweet crude oils from the inland United States such as WTI crude oil - lower costs than benchmark sweet crude oil

Sustainable Annual Dividend Yield

Competition Profile

Marathon Petroleum Corp. (NYSE:MPC)

- Engage in refining, marketing, and transportation of petroleum products in the U.S. only
- Undertaking an acquisition of Andeavor for $23 Bn USD

Exxon Mobil Corp. (NYSE:XOM)

- Engages in the exploration, development, and distribution of oil, gas, and petroleum products.
- Involved in all aspects of the energy sector through Upstream, Downstream and Chemical segments

Phillips 66 Company (NYSE:PSX)

- A downstream energy company processing, transportation, storage, and marketing of fuels and other related products

Chevron Corp. (NYSE: CVX)

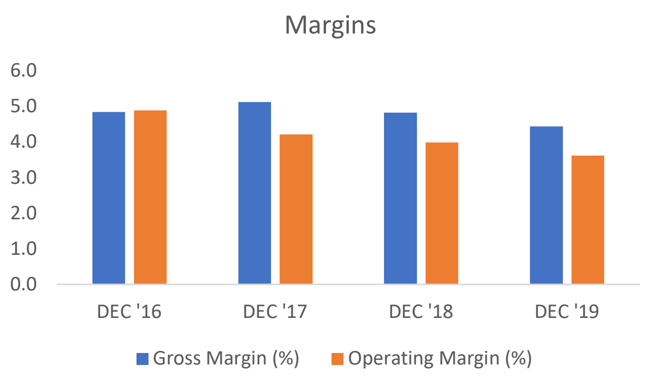
- A downstream energy company
- Current ambitions include streamlining operations internationally

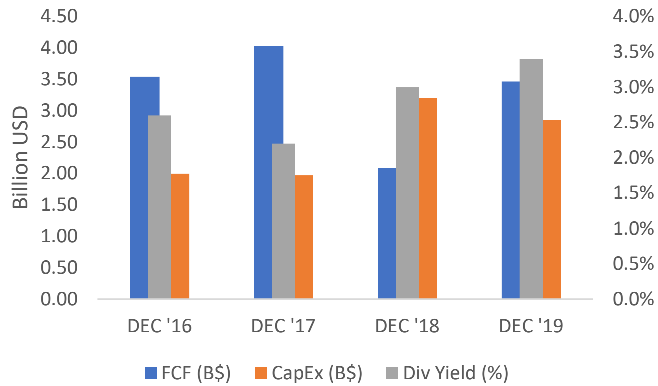
(1) Source: IBIS World, (2) Source: FactSet

Financials

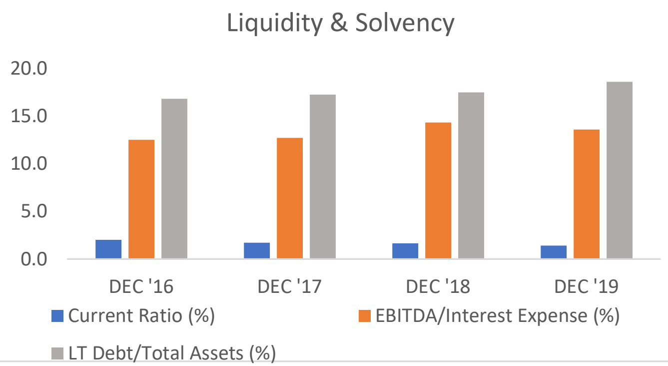
Profitability, Liquidity and Solvency

Profitability





Liquidity & Solvency



Key Takeaways

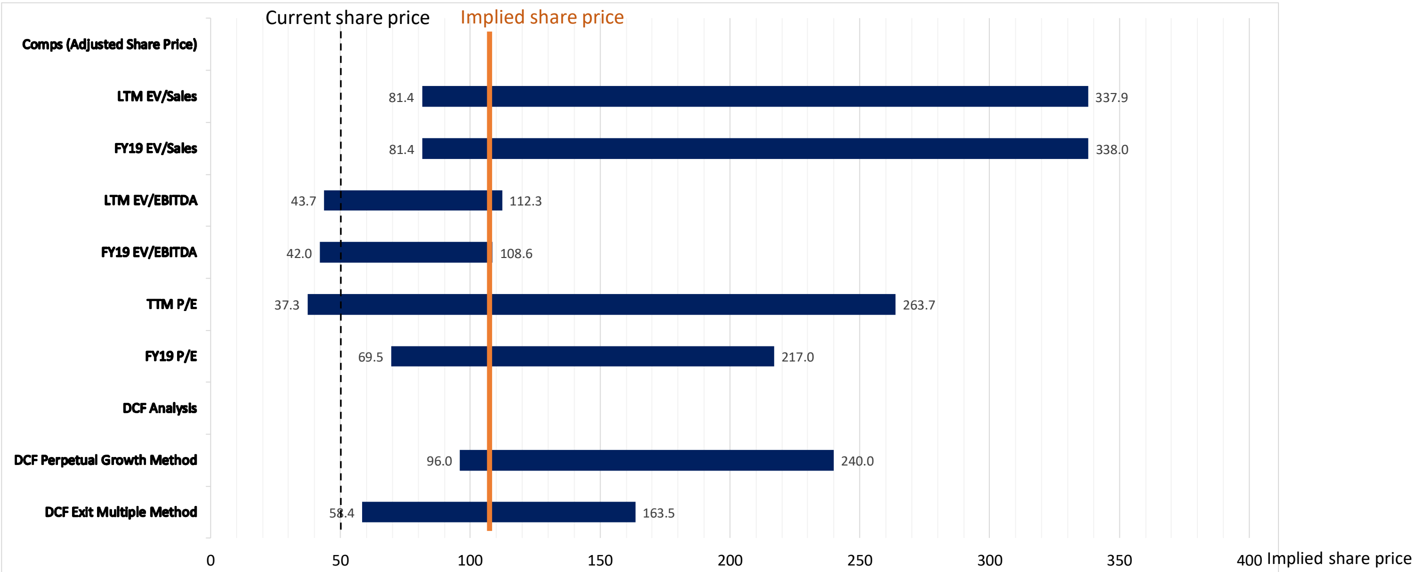
- Stable and positive profitability at 4.2% gross margin
- Strong dividend paid policy at 3%
- Increasing Capex at 9% CAGR to 2019
- Solid liquidity outlook with Altman Z-Score around 3.9

(1) Source: IBIS World, (2) Source: FactSet

Valuation Summary

Equity Valuation in-line with Current Price

Valuation Summary



$110.0

Implied share price

Key Valuation Drivers

- Active M&A strategic deals drive future Ethanol and Refining sales growth at 9% (1. VLP Merger, 2. Green Plains Inc. Ethanol Plant Acquisition, 3. Pure Biofuels del Peru S.A.C. Acquisition)
- Continuous capex investments in renewable energy market.
  Sales volumes of renewable diesel and tax credit benefit drive renewable diesel sales to grow at 15% CAGR to 2024, aligned with green energy market growth
- Adjusted stock valuation weighted as 50% DCF (EEM, PGM) and 50% Trading Comps (P/E, EV/EBITDA, EV/Sales)

(1) Source: IBIS World, (2) Source: FactSet, (3) Source: MD&A Report

南山人壽

Investment Risks

Risk Analysis and Impacts

Environmental Concerns

- Paris Agreement could still affect operations in Canada, the U.K., Ireland, and Latin America
- Operations are subject to extensive environmental laws and regulations, including waste management, pollution prevention measures, greenhouse gas (GHG) emissions, and composition of fuels

Volatile Refining Margins

- Decline in market prices negatively impacts the carrying value of inventories per LIFO method
- Interplay between the expanding US influence in global oil supply and demand from Asia and the Middle East posts uncertainties
- Global energy transitions to a decarbonising world, faced with weaker transport fuel demand

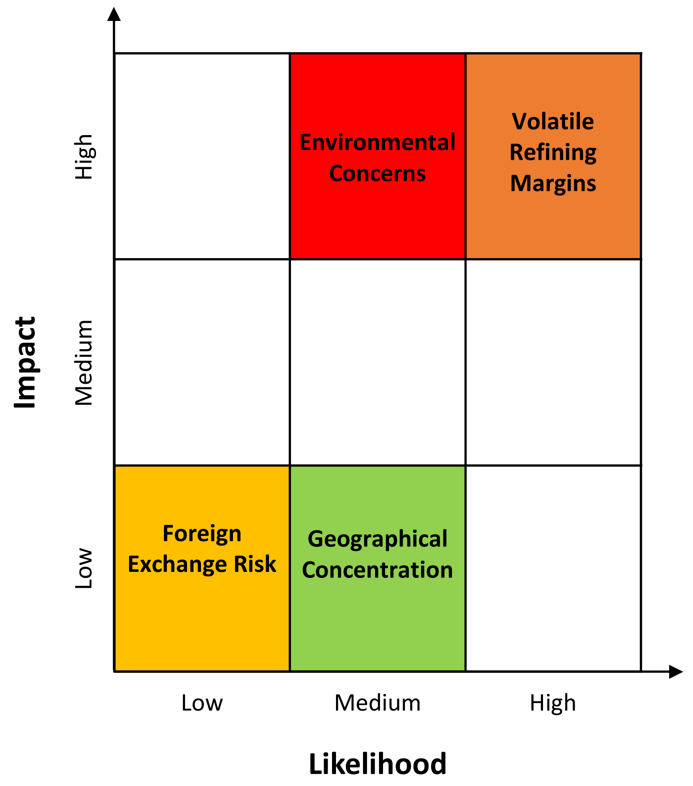
Foreign Exchange Risk

- Majority of the firm’s operations reside in the United States
- Appreciation of USD weakens reporting results due to exports to the Europe and Asia, accounting for 30% revenue
- Insignificant FX hedging

Geographical Concentration

- Production facilities are mostly located within North America
- Harder to penetrate foreign markets
- Not have a company-owned retail network such as produce crude oil feedstocks whereas main competitors do

Risk Matrix



(1) Source: MD&A Report, (2) Source: FactSet

Investment Theses

Strong Business Model Drives Potential

1

Recurring Revenues

- Firm has diversified base of customers locked into yearly contracts- consistent gross profit margin with high earning quality
- Improving derivatives revenue designated as economic hedges
- Continuous production expansion in areas of reusable diesel, matching market trends

2

Vertically Integrated

- Manufactures products from refining crude oil to consumer-ready products driving down supply chain risk
- Allows for moderate and stable margins while maintaining market share of 15%

3

Organic Growth Opportunities

- Global GDP, total vehicle miles and related consumption expected to rebound beyond 2021 and offset the adverse effect of Covid-19
- Competitive ROE paired with stable cash flows

4

In-Organic Growth Opportunities

- Various M&A deals to capture Mexico and Latin America industry growth and become competitively well-positioned
- Many smaller players in North America which leaves room for industry consolidation

5

Capital Structure

- Stable free cash flows and EBIT/Int. Exp. Multiple of 7.2x have allowed Valero to pay off near-term debt leaving their operations equity funded
- Stock Purchase Program has reduced the outstanding shares (remaining $1.5 Bn available for purchase)

(1) Source: MD&A Report, (2) Source: FactSet, (3) Source: IBIS World