Valero Energy Corp. (NASDAQ: VLO)

Industry: Energy

Rating: HOLD, Target Price: $167 – Implied Upside/Downside: **-36% (as of June 29th, 2026)**

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THESIS

Pareto Capital initiates coverage of Valero Energy (NYSE: VLO) with a HOLD rating and a 12-month price target of $167.

Valero is among the best-run independent refiners on the planet: Gulf-Coast-weighted, intricate enough to turn heavy-sour discounts into margin and levered to a structural refining-capacity shortage that is entirely real. The issue is the entry, not the enterprise. At its current quote near a 52-week high, the stock requires the crack spread to hold close to the top of its historical range (more or less) permanently. On the other hand, our normalization work puts fair value *above even our bull case* at today's price, with through-cycle value landing in the $135–$185 range across an EV/EBITDA scenario build and an independent multiple valuation. Plainly put, the market is capitalizing a wartime margin as if it were mid-cycle. We don't believe it is. The recent surge is a geopolitical premium–soft Brent against product cracks spiking on Strait-of-Hormuz disruption and a distillate scramble–and premiums like that evaporate. When cracks normalize the stock reprices with them, and there is little underneath to cushion the move.

The only constructive way to engage from here is tactical (perhaps a swing trade on fading momentum) with respect to the macro environment. We would rather be early to the next entry than late out of this one.

MACRO ANALYSIS

Valero is the largest independent refiner in North America with roughly 3.2 million barrels a day of throughput across about fifteen plants on the US Gulf Coast, the Mid-Continent, the West Coast, and in the UK and Ireland. This is bolted to a half-share of the Diamond Green Diesel renewable-diesel JV and a fleet of ethanol plants. Valero owns no upstream; it pumps no oil of its own. That makes it a pure expression of the downstream: it buys crude at one price, runs it through expensive and complex machinery, and sells fuel at another. That gap is everything.

That gap goes by two names. The first is the **crack spread**: the value of refined products over the crude used to make them. Refiners talk in "3-2-1" abbreviation (three barrels of crude into two of gasoline and one of distillate, a simplification of production processes), but Valero's real crack is yield-weighted to its own output, closer to 57% gasoline and 43% distillate. When product prices outrun crude, the crack widens and every barrel earns more; when they converge, a refinery can run flat out and still lose money. The second, is the **crude differential**. Not all crude is priced alike as heavier, sourer, or stranded grades trade at a discount to light-sweet benchmarks because few refiners can stomach them. Valero can, thanks to its coking capacity and complexity, so it buys the cheaper barrel (Maya, sour grades) and sells product priced off the expensive one. The wider that discount, the freer the margin.

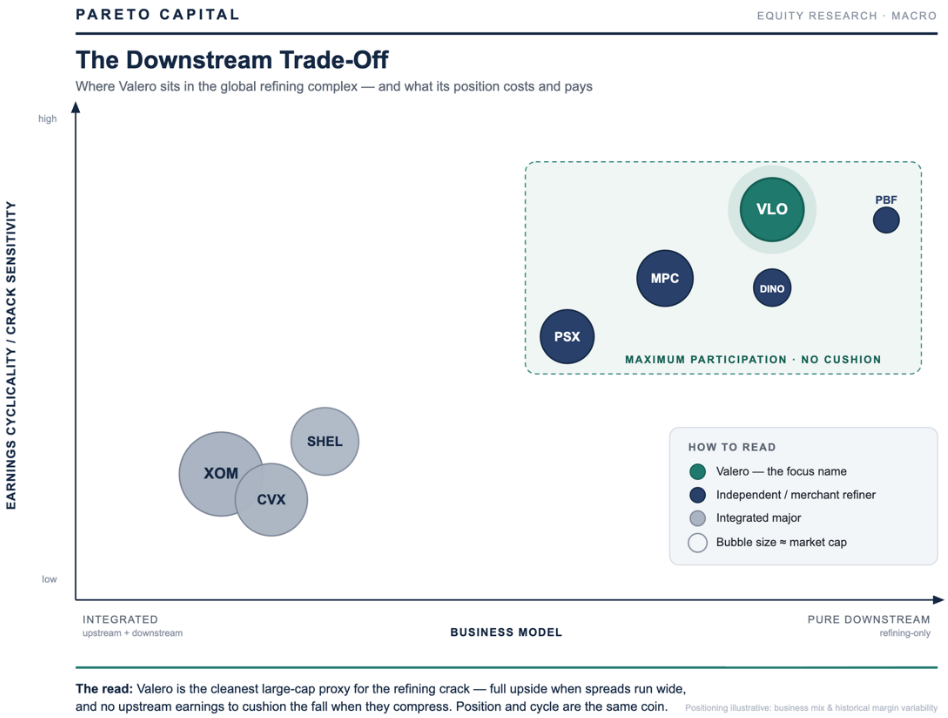
The non-obvious consequence: **a refiner is long the spread and roughly indifferent to the level of oil.** Crude is a pass-through cost, not a product. Counterintuitively, Valero often does *better* when crude falls, provided product prices are slow to follow. Evidently so, this is precisely the present configuration (soft Brent, spiking cracks). As such, a categorical error would be to interpret Valero's value purely based on oil prices (there's correlation, of course, but more nuance beyond that).

The refining margin is a small residual between two enormous, volatile numbers. A move of a few percent in either crude or product prices swings the spread (i.e. operating income per barrel) violently. That is operating leverage before a single fixed cost enters the picture. On the demand side, fuel consumption moves with GDP, miles driven, freight volumes, air travel, and seasonal patterns such as summer gasoline demand and winter distillate demand. On the supply side, global refining capacity is being reshaped by years of U.S. and European closures alongside new mega-refineries in Asia and the Middle East, making Valero’s earnings a high-beta reflection of the global product-supply balance.

Geopolitics rides on top as the accelerant. Sanctions redraw crude-quality flows (Russia, Venezuela, Iran), OPEC+ dictates how much heavy-sour barrel reaches the market, and acute shocks can blow product cracks far past anything demand fundamentals would justify. Those moves are real cash while they last and air pockets when they fade.

Valero's pure-downstream posture is simultaneously its greatest strength and its defining vulnerability, and the two cannot be separated. On the **pro** side, it offers undiluted leverage. When the refining cycle is tight, Valero captures all of it, with none of the upstream drag that mutes an integrated major's downstream win — it is the cleanest large-cap way to simply be long refining. Its complexity and slate flexibility let the Gulf Coast system run the cheap barrels competitors can't, monetizing the crude differential rather than merely surviving it. Its geography gives waterborne access to discounted crude and to Latin American and European product demand, so it is never trapped behind inland pricing. Moreover, its scale, low-cost structure, and balance sheet fund heavy buybacks and dividends straight through the cycle.

On the **con** side, the same purity means no cushion. Integrated peers (Exxon, Chevron, Shell, BP) own upstream that earns precisely when cracks compress; Valero owns the downside of the spread outright. Among the merchant refiners it competes with most directly such as Marathon, Phillips 66, HF Sinclair, it is the highest-beta expression of the group. It is a price-taker on both ends with zero pricing power. Furthermore, Valero carries a secular demand overhang, as gasoline drifts into structural decline from EV adoption and efficiency, which caps the terminal value the market will underwrite and is a chief reason refiners trade on low, deliberately cycle-aware multiples even at peak earnings. And it bears idiosyncratic operating risk, a fancy way to say that single-asset events such as the recent Port Arthur fire, scheduled turnarounds, and Gulf-Coast storm exposure coupled with policy whiplash pose unquestionable challenges.



FINANCIAL ANALYSIS AND VALUATION

As mentioned, Valero buys crude and sells refined product, which means its revenue line is largely a transcript of commodity prices and tells you almost nothing about whether the company made money. The profit lives in two spreads: the *crack* and the *crude differential*. Throughput is just the multiplier on those spreads. Ethanol and a half-share of the Diamond Green Diesel renewable-diesel JV round out the segment mix, but refining is roughly nine-tenths of the earnings. We decided to take this one-sidedness into account with our analytic approach.

Valero runs ~$130B in annual revenue through razor-thin, swinging margins and net income has whipped from near-breakeven to over $11B in the span of a few years. We won't dwell on the standard income-statement, balance-sheet, and cash-flow walkthrough here, because for a refiner those figures are hostages to the cycle. Indeed, any single quarter of a refiner's earnings is a photograph of the cycle, not a measure of its earning power. The exercise that matters is **normalization** as in what does Valero earn per barrel in a *mid-cycle* spread environment, and what is that worth? If we could gain a clearer picture of what earnings might look like down the line, we'd have a system to ground our financial model in. As such, we built a process to answer that and then to attack the answer from several directions to see whether it holds.

First, we regressed Valero's adjusted refining operating income per barrel on two purpose-built market factors:

$$\textbf{OI/bbl} = -7.52 + 0.62 \times (\textbf{Synthetic Crack}) + 0.90 \times (\textbf{Crude Differential})$$

The beauty is in how the factors are constructed. The synthetic crack is a *yield-weighted* blend of the USGC gasoline and diesel cracks (0.57 / 0.43, set by Valero's own gasoline-to-distillate output mix); the crude differential is a *slate-weighted* blend of Brent–WTI and Brent–Maya (0.67 / 0.33, set by its sweet-versus-heavy-sour feedstock mix). Generic benchmark cracks would have produced a generic, mushy fit. Weighting each factor to Valero's actual configuration is what lets two variables do the work of ten: across 25 quarters (2020–2026) the model explains 87% of the variance in OI/bbl ($R^2 = 0.866$). Both coefficients survive heteroskedasticity-robust (HC3) standard errors, the signs are exactly what economics demands (as in wider cracks and a wider feedstock discount each lift the margin), and the negative intercept is simply the fixed-cost hurdle a refiner clears before spreads turn into profit. A clean, intuitive model is the product of our regression.

We then tried to break it. A high R^2 on 25 in-sample points proves very little on its own, so the model went through four stress tests. *Residual diagnostics* came back well-behaved and normally distributed (Jarque-Bera $p = 0.11$) with no autocorrelation (Durbin-Watson 2.12). *A walk-forward backtest* (train on the first twelve quarters, predict the next, re-estimate, repeat) produced a mean absolute error of ~$1.18/bbl across thirteen out-of-sample quarters, a 65% improvement on a naive historical-average baseline. *Rolling-window coefficients* held steady through the period, and a Huber re-estimation returned near-identical betas. **The relationship, in short, is predictive and not a fluke.**

Scenario inputs come straight from the historical distribution of the two factors — Bear, Base, and Bull are the 25th, 50th, and 75th percentile spread environments. Each case's predicted OI/bbl is carried through a full bridge: multiplied by throughput and 365 days for refining EBIT, added to separately normalized Ethanol and Renewable Diesel EBIT, net of corporate cost, grossed up to EBITDA, and valued.

Case	Synthetic Crack	Crude Diff	Normalized OI/bbl	Implied Price (EV/EBITDA)
Bear	$9.28	$4.44	$2.27	~$61
Base	$12.70	$5.52	$5.37	~$135
Bull	$15.70	$6.62	$8.23	~$218

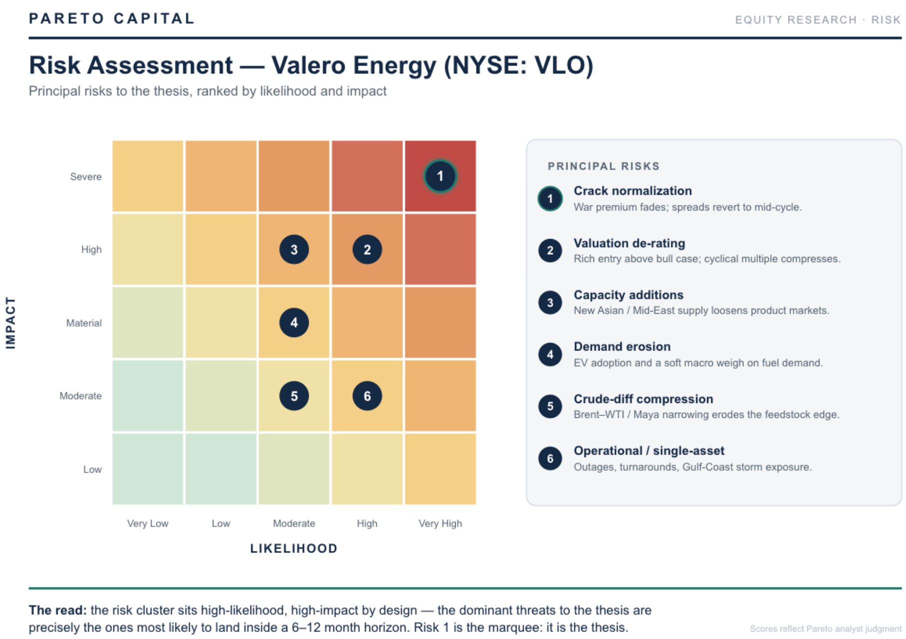
EV/EBITDA is the primary lens (P/E is a cross-check only; loss-case EPS is uselessly volatile for a cyclical). At a mid-cycle 5.5× on base EBITDA, net of ~$5.8B debt over ~298M shares, the Base case lands near $135**.** Because rising refining income is itself a peak-cycle tell, we also let the exit multiple *compress* as OI/bbl climbs which walks the Bull case back from $218 to roughly $184. An independent DCF on normalized operating income corroborates the middle of the range at **~$167**. The conclusion is evident: every method we ran sits well below the current quote, which means the market is paying for a spread environment nearer the top of the historical distribution than its center.

Monte Carlo, as a final referee. The percentile cases have one slight flaw: they take the 75th percentile of *each* factor independently, even though cracks and differentials are positively correlated, which makes the tails a touch too convenient. To address this, we ran 10,000 simulations that sample the two factors jointly off their historical covariance, then layer in coefficient uncertainty, residual noise, and a distribution of exit multiples. The implied-value distribution centers near the Base case with a wide P10–P90 band of roughly $24–$295.

The result of this multifaceted approach was a resounding confidence in our valuations with a considerable margin for error. Even considering the slightly differing results from the approaches we took between pure fundamentals and a more simulated version, our analysis was only bettered. A combination of cyclicality and Valero’s inherent downstream positioning has allowed the market to create an overpriced juggernaut. It’s not necessarily poised to fall soon or sharply but beckons a rational investor to remain cautious with his/her next move.

RISKS & VERDICT

Valero is a superbly engineered instrument for a single trade: being long the refining crack. That is a virtue when you want the exposure and a liability the moment it turns. Today's macro backdrop, a cacophony of low crude, war-inflated product cracks, and geopolitical uncertainty, is exactly the environment in which a pure downstream refiner looks unstoppable. The market tends to pay up (perhaps excessively) for this very reason. Positioning and cycle are two faces of the same coin; the only open question is whether the probability of either is truly even.



What tips the cases. Because the crack carries ~0.88 of the variance, the signposts to watch are spread signposts, not earnings prints. The model drifts toward the **Bear** case as the synthetic crack compresses toward ~$9 with the drivers being new global refining capacity coming online, demand erosion), and a narrowing of the Brent–WTI/Brent–Maya differentials. It tilts **Bull** when cracks stay wide or widen capacity closures, supply dislocations, and a heavy-sour discount that bolsters Valero's complex, Gulf-Coast-weighted system. Diesel is the one to watch most closely: it carries the heavier weight in the synthetic crack and has been the tighter of the two product markets. The cracks that made this price, will, at some point undo their work. We caution against entry amongst this frenzy as a result and instead look to capture upside during the next market rotations (human nature simply guarantees such events).

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