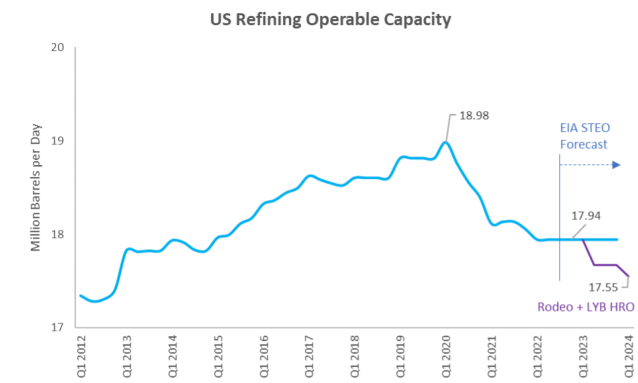


PBF Energy

\$PBF Energy is a leading US refinery with a capacity of over 1 million barrels per day. Refinery businesses have, historically, been very volatile and aren't without risks. PBF was founded in 2008 by several private equity firms, including Blackstone, with a pool of capital looking to acquire distressed refinery businesses for the long run.

We believe PBF has made investments and changes that make them an incredibly attractive investment. During covid, they nearly went bankrupt due to the massive compression in gasoline and oil consumption with debt on their balance sheet. However, due to the massive spike in crack spreads during 2022, they are now in a zero net debt position. The CEO of Chevron recently said he doesn't believe another US refinery will ever be built. This notion is critical, because US refining capacity is below pre-pandemic levels as many competitors went out of business in 2020, and refineries are operating near maximum capacity.

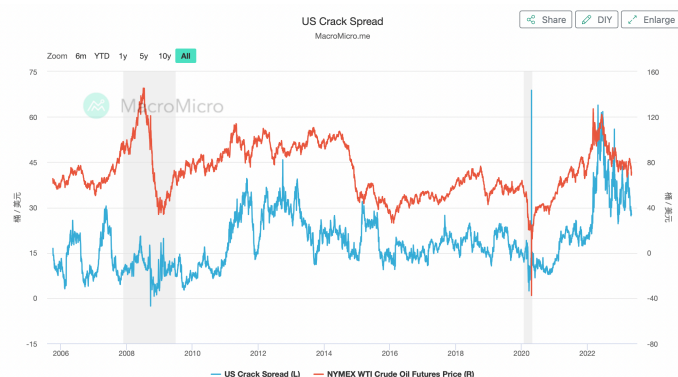


Bull Case:

Typically if a stock trades below 2x earnings, there's a reason. PBF currently trades 1.4x earnings and pays a 2.5% dividend. In PBF's case there is a reason it trades at such a low earnings multiple, and that's because many analysts don't expect their big profit margins to continue. However, the company just announced another 500m buyback, in addition to the 500m buyback they announced last December, making the stock more compelling if profit margins were to get more lean, and expanding our share of the profits if they stay strong. Buying back \$1bn of the stock is over 20% of the current total \$4.1bn valuation. They view their stock as having immense value, and view their balance sheet as being in a good enough position to return capital to shareholders.

The reason for PBF's low earnings multiple is twofold. The largest issue is that Wallstreet analysts don't expect crack spreads, the spread between gasoline and oil that is a rough calculation crucial to refiner profits, to maintain at high levels.

Crack spreads have maintained themselves at strong levels so far this year, and despite a continued



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drop in the price of oil. This crack spread strength has allowed PBF to generate an additional \$514.5m in operating income and \$382m in net income during Q1. The company says “We expect that the market in 2023 will continue to support better than mid-cycle financial results for PBF,” implying they expect crack spreads to remain healthy and for PBF to generate above average profits for the foreseeable future. Considering, after Covid, the CEO of Chevron says it’s unlikely we see another US refinery, there is good reason to believe this will be the case. Gasoline prices have already come down dramatically from their highs and demand is strong. In fact, 9 out of the last 11 weeks have seen gasoline draws from storage, despite releases from the SPR. We are now entering the seasonally strong driving season, and despite the compression in Oil and RBOB, PBF’s earnings have remained strong, they have dramatically improved their balance sheet to zero net debt, and are buying back substantial stock with commentary of more capital return programs to come.

Many may be concerned around the risk of EVs reducing the long term demand for Gasoline. While this is a justifiable concern, if PBF can maintain a fraction of its current profitability the company will make its entire current market cap, without any additional share buybacks, in just a few years. There will be many needs for refining petroleum for decades after gasoline demand has gone to 0. Gasoline demand isn’t expected to peak until 2050, though. However, the business has already begun allocating to its long term future, investing in both renewable diesel and renewable jet fuel projects.

Bear Case:

Refining is a historically high risk business with many variables. When things are good, they’re very good, but when things are bad, only the strong survive. While I believe PBF is in the position to be strong and to survive, risks are still present and must be monitored.

A severe recession that leads to a massive increase in unemployment, coupled with companies choosing to slash office real estate costs and have more employees work from home would be negative for PBF. Given that oil supply is currently tight outside of artificial supply from the SPR, this drop in gasoline consumption would negatively impact crack spreads and PBF’s bottom line profits.

While there likely won’t be another US refinery built and US refineries are currently operating near maximum capacity, that doesn’t mean existing refineries won’t be expanded or new efficiencies won’t be found. We should expect that as refined products demand continues to grow over the next many years, existing refineries will be incentivized to grow production in any way they can to capture that additional business. PBF may be one of those companies, and it’s unclear if shareholders would look favorably upon capital investment over capital returns. Such an investment could provide a negative immediate catalyst for the stock, as could significant expansion of competing refineries during a downturn in crack spreads.

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While there likely won't be another US refinery built, that doesn't mean the world's largest refiner as of 2022, China, will avoid producing new refineries. While China's refinery utilization this year is lower than ours (China, ~73% last year and ~79% this year, vs US ~90% both years) China has plans to introduce new refineries as their energy demands continue to grow. Saudi Aramco has recently announced an investment in a new Chinese refinery and intends to provide crude oil for them to refine. However, this refinery doesn't come online until 2026 and its impact on China's overall refining capacity is an incremental 300k barrels per day.

Overall the theme with China is while they have the world's largest capacity, the world's largest output comes from the US. Note their refinery utilization above. China is growing rapidly, and it makes sense for them to hedge such critical economic resource supply to the upside. However, refineries won't operate unless they are profitable, so while they continue to invest in refinery capacity, it appears the desire to expand output isn't beyond what the market demands. Additionally, unlike the US, the Chinese government appears to desire increasing strategic supplies of resources, given their access to natural oil is limited, and could leave them vulnerable in the event of international conflict.

Conclusion:

While risks are certainly present in any investment, they are very easy to see with refiners. However, a company trading at 1.4x earnings, paying a dividend, and buying back 20% of its stock needs a lot to go wrong in a big way for it to be considered a bad and expensive investment. PBF is trading at a very attractive valuation and even if Crack spreads were to break lower to more historical norms as analysts already predict and currently price with the stock, the business would still trade at a reasonable valuation. Last year's spike in crack spreads allowed PBF to produce tremendous cash and pay off loads of debt, leaving them in a positive cash position. They're buying back an unusually high amount of stock, \$1bn or over 20%, indicating they see value in its price. The former CEO and now Chairman is the largest individual shareholder has successfully guided this company from a pile of cash looking to acquire distressed refinery assets to one of the leading refiners in the world, generating good profits, and returning lots of capital to shareholders.