Earnings in commodities-based industries tend to be cyclical and can vary widely from year to year. For fuel refiners that sell gasoline, diesel and jet fuel commodities, the last few quarters have seen an upswing in earnings on the heels of the major financial losses fuel producers absorbed during the pandemic. It has been a welcomed period of demand recovery and rebuilding business, but history tells us it won't last.

Because of the up-and-down reality of refining, it would be a mistake to regulate or legislate based on the high points. A few quarters of earnings don't provide an accurate representation. Similarly, refiners don't base their growth plans and investments on momentary high returns. They take the long view and consider demand forecasts, workforce and operational costs and present and future policy environments when deciding how to allocate earnings.

That context is important for answering the question of what happens with refinery profits and whether using earnings to "buy back" stock is in fact an appropriate use of those funds. Let's get into it.

Publicly owned companies, like many U.S. refineries, have a fiduciary responsibility (which is a legal obligation) to act in the best interest of their shareholders, and that extends to how companies spend their earnings. Often, they do a combination of the following:

Companies can pay direct dividends to shareholders.

If they go this route, companies divide and distribute some or all of their profits proportionally among their owners (aka shareholders).

Companies can re-purchase or "buy back" shares of stock.

One of the ways companies raise capital is by issuing shares, or stock, for sale. Companies can use profits to re-purchase and retire some of their stocks. Taking shares off the table increases the value of remaining shares or stocks held by company investors. Investors include a wide range of people—among them, individual buyers, retirees, public employees and service workers, and anyone with 401k and mutual fund accounts—who collectively own the company. Investors will profit in this case if they cash out and sell their shares. Buying back stocks is common across many industries:

- **Tesla** CEO Elon Musk indicated in the company's Q3 2022 earnings call that a stock buyback program is being considered.
- In October, **Visa** announced a $12 billion buyback program.
- **Texas Instruments** is spending $15 billion to repurchase company shares per a September announcement.
- **Johnson & Johnson** announced in September that it will launch a $5 billion buyback program.
- **Alphabet** (**Google**'s parent company) announced in April that its board of directors authorized $70 billion in share repurchases.

- **Apple**'s board of directors in April approved a boost to their buyback program totaling $90 billion.
- **HSBC**, one of the largest banking and financial services institutions in the world, announced the launch of a $1 billion share buyback plan in May.

Companies can retire or pay down debt.

COVID cut into demand for refined products and many U.S. fuel manufacturers had to reduce operations and readjust. One U.S. energy company with a big refining arm noted publicly that they lost $20 billion over the pandemic and had to borrow an additional $30 billion to maintain essential operations and be ready for post-pandemic demand. Borrowed money, like credit card debt, has to be repaid with interest. The faster debt gets paid off, the less you owe in interest. Using earnings to retire or pay down debt is a wise and attractive decision for many companies and several have used their 2022 earnings to reduce debt.

Capital intensive companies can re-invest profits into new process units, improved operations, building projects, acquisitions and hiring.

Beyond essential facility upkeep and maintenance—which is budgeted into regular operational costs—companies may choose to re-invest profits in business expansion projects—particularly if the economy and demand projections are strong. Amid economic and regulatory uncertainty or talks of recession, companies may opt away from new investments. With the current political and financial attitude toward fossil fuels—which has been described by some as “drill today, disappear tomorrow”—many shareholders are questioning the wisdom and risk associated with long-term investments in refining and liquid fuel production. They fear money invested in new projects could become “stranded” and never reach the point of profitability before the political rug gets pulled out from under them. Restarting a refinery or building a new processing unit at an existing refinery are major projects not easily turned off and on in the span of a two- to four-year political cycle.

- A lot of focus right now is on investment in upstream oil production. AFPM and the refining business itself are distinct from the business of exploration and production, but here is a useful data point: for companies exploring new wells and drilling projects, it can take anywhere from **7-10 years** to produce energy and even longer to become profitable.
- On the refining side of the business, building a new process unit to increase fuel production capacity is a massive investment—often costing billions of dollars. At those costs, it can take **15-20 years** for a project to become profitable.

Notice what’s not an option:

Discounting wholesale fuel from refineries. Refiners do not set prices for the wholesale fuel they sell. The price of refined product at a given moment depends on the global and regional supply of that product compared to demand. In real time, market prices change in response to movements in the petroleum supply chain and the behaviors of market participants—refiners, wholesalers, commodities traders, distributors and fuel retailers. If U.S. refiners were to offer wholesale gasoline blendstock below market price, other participants in the supply chain would snap it up and sell it at market value to the next link in the chain. Artificially lowered prices would encourage an uptick in demand and further stretch limited supplies—the exact opposite of bringing the market into better balance. Additionally, selling gasoline blendstock for less than it is worth would violate companies’ fiduciary responsibility to shareholders. Manipulating the price and artificially discounting product is not an option for U.S. refiners.

Just because a refinery puts its earnings to work through stock buy backs or retiring debt does not mean that it isn’t also making every effort to support U.S. fuel production and the rebuilding of our liquid fuel stockpiles. American refineries have operated in recent months at near full utilization—a stunning level of effort that has contributed more gasoline, diesel and jet fuel to the global market than any other country. This is not a zero-sum game. What refiners are doing is meeting their fiduciary obligations to shareholders while also amply supplying both our country’s and our allies’ energy needs.

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About AFPM:

The American Fuel & Petrochemical Manufacturers (AFPM) is the leading trade association representing the makers of the fuels that keep us moving, the petrochemicals that are the essential building blocks for modern life, and the midstream companies that get our feedstocks and products where they need to go. We make the products that make life better, safer and more sustainable — we make progress.

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