BN EXCLUSIVE: Valero Board OKs $1.4 Billion Plant Expansion

((Bloomberg reporter Victor Epstein wrote an exclusive story about expansion plans by the largest U.S. refiner, Valero Energy Corp. He obtained an internal Valero memo, confirmed by the company, that showed board approval for the expansion.))
NXTW NSN JR1LGNOYHQOY

Valero Board Approves $1.4 Billion Plant Expansion (Update1)

2007-11-05 21:20:13.110 GMT

(Updates share price in 13th paragraph.)

By Victor Epstein

Nov. 5 (Bloomberg) -- Valero Energy Corp., the largest U.S. refiner, will go forward with a $1.4 billion expansion at its St. Charles, Louisiana, refinery, the most expensive plant upgrade ever approved by the company's board.

The project will expand the plant's processing capacity by 50,000 barrels of crude a day, or 20 percent, Valero spokesman Bill Day said today. Day, who confirmed the board's approval and project details contained in a company memo obtained by Bloomberg News, said the expansion will increase diesel output.

``We're concentrating on diesel production because we think that's where the future U.S. demand growth will be strongest as more ethanol is blended with gasoline,'' Day said in a telephone interview.

San Antonio-based Valero in September pegged the cost of the proposed St. Charles expansion at $1.25 billion. Valero's board hasn't yet approved an upgrade at a plant in Port Arthur, Texas, estimated in September to cost $1.75 billion, or a $900 million project at a plant in Quebec.

``Valero is setting up their system like a super-major, such as Exxon, by building capacity in areas like the Gulf Coast where they have more sale options'' for their fuel, said Chi Chow, an analyst at Tristone Capital USA in Denver who rates the company's shares a ``top pick'' and doesn't own any.

Chow said Valero will have the option of selling ultra-low-sulfur diesel in Europe, which is increasingly running short of production capacity for the fuel.

Reliability Push

Chief Executive Officer Bill Klesse also seeks, through plant upgrades over the next five years, to improve the reliability of Valero's refineries. Valero had $850 million in so-called lost-opportunity costs in the first six months of this year on plant breakdowns. Klesse said in September that the company's plants ranked in the third quartile for reliability among U.S. refineries.

The St. Charles project will include construction of a new unit called a hydrocracker and expansions of two existing units. Hydrocrackers convert heavy molecules into lighter fuels, such as high-octane gasoline.

Valero also will upgrade a unit called a delayed coker, which handles heavy, high-sulfur crudes that sell at a discount to lighter grades. The company already has the largest U.S. capacity to process heavy crudes.

``This will increase Valero's advantage processing heavy and sour feedstock into light products,'' said Charles Ting, an analyst at Lehman Brothers in New York.

Diesel, Gasoline Gains

The expansion will make the St. Charles plant one of Valero's top three refineries in terms of profit per barrel of crude processed, Chief Operating Officer Rich Marcogliese told employees in the company memo. The project will be completed in 2010, he said.

The plant's daily output will increase by 49,000 of ultra-low-sulfur diesel and 11,000 barrels of gasoline, Valero said.

Valero shares fell 14 cents to $69.42 in New York Stock Exchange composite trading. The stock still has jumped 36 percent this year.

Valero's 17 refineries can process 3.1 million barrels of oil a day.