

US Condensate Exports/Equity View

Alert: Small steps to export condensates point to big leap to US crude exports this year; but coastal refiners retain advantage

Commodities View: *The Wall Street Journal* and Reuters reports late yesterday that the Bureau of Industry and Security at the US Department of Commerce had approved the first export licenses for "unrefined" condensates to two companies, Pioneer Natural Resources and Enterprise Products Partners, came as no surprise – except for the timing. In decision-making in bits and pieces, the Commerce Department's later clarification that these licenses are not for unrefined lease condensates, but for lease condensate that has been processed – through a stabilization unit, it seems – bears significantly more implications than the modest statement. The minor process that has been approved isn't so minor and is something long expected – a ruling on how lease condensate can be transformed into a petroleum product, and thus exportable under general license. What is a notable step towards greater crude exports (though it would be classified as product exports) is that this is not through a condensate splitter or a distillation tower, but a simple stabilization unit.

There may be some 200-k b/d of stabilization unit capacity on the US Gulf Coast, perhaps more – liquids-rich gathering and processing systems also have stabilization facilities which allow condensate barrels to be transported more easily. Processed condensate exports could begin as early as August. Markets are looking for any way possible to export the growing surplus of condensates (super light sweet crude oil) that are being produced from shale/tight oil plays. As much as 70% of Eagle Ford output might be condensate, which is wanted neither by producers nor refiners, and now US policymakers seem to be providing quiet encouragement.

As noted in Citi's recent report ("[Mind the Gulf](#)") the US can potentially export some 300-k b/d of condensate as part of as much as 1-m b/d of crude oil exports by the end of the year, and yesterday's news further reinforces the outlook. Other components of the export growth are: sales to Canada, which reached 270-k b/d in April and look likely to exceed 400-k b/d by year end; exports to Mexico amounting to more than 100-k b/d, under an exchange program to increase light product yields in Mexico's refineries; re-exports of Canadian crudes of at least 200-k b/d (which already contain condensates from the US used as diluent and are creating unstated problems of allowing the condensates – now part of Canadian bitumen – to be further re-exported to Europe); and exports from Alaska, allowable under current law and made economic by a growing glut of Mexican, US and Canadian railed crude on the US West Coast, more than 100-k b/d.

Equity View: The announcement on condensate exports is in line with our expectations (Note: [Impacts of Changing Crude Dynamics on US Gulf Coast](#)). Rising condensate production and its blending with neat crude streams has been causing problems for the refiners as it was producing more light ends than they could handle along with affecting the refining yields. (*continued overleaf*)

- Commodities
- Equities

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Equity View, continued: In the absence of an unconditional export ban, which is not the case here, we don't expect meaningful impact on our expectations for refining profitability. We believe that coastal refiners in the US will continue to have an advantage as improving logistics allows for greater flexibility in crude procurement and product placement. This is also in line with our long-term estimate for Brent vs. US light sweet crude price differentials of \$5-\$7/Bbl. It is also important to note that the announcement does not change our view on widening of price differential between heavy and medium sour crude oil versus light sweet crude oil. We believe that the expansion the heavy light spread will be the key theme going forward and we reiterate our Buy rating on VLO which we believe is in the best position to benefit from this theme.

Appendix A-1

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Valero Energy Corp (VLO)

Ratings and Target Price History Fundamental Research

Analyst: Faisal Khan, CFA



	Date	Rating	Target Price	Closing Price
1	22-Jul-11	2H	*28.31	24.40
2	8-Oct-11	Stock rating system changed		
3	8-Oct-11	*1H	28.31	18.07
4	17-Sep-12	*2H	*31.97	29.26

* Indicates change

	Date	Rating	Target Price	Closing Price
5	23-Jan-13	2H	*36.53	34.68
6	28-Apr-13	2H	*37.45	37.19
7	27-Jun-13	2H	*41.00	34.99
8	2-Oct-13	*1H	*42.00	34.38

	Date	Rating	Target Price	Closing Price
9	6-Jan-14	*1	*56.00	49.83
10	7-Apr-14	1	*63.00	51.91

Rating/target price changes above reflect Eastern Standard Time

Valero Energy Corp (VLO)

Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Faisal Khan, CFA



	Date	Rating	Target Price	Closing Price
1	2-Dec-11	*ADD MP	-	20.61

* Indicates change

	Date	Rating	Target Price	Closing Price
2	17-Sep-12	*REM MP	-	29.26

Rating/target price changes above reflect Eastern Standard Time

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