VALERO ENERGY CORP/TX
Form 424B5
April 08, 2002

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PROSPECTUS SUPPLEMENT Issued April 8, 2002 (Subject to Completion)
(To Prospectus dated April 5, 2002)

FILED PURSUANT TO RULE 424(b(5)
REGISTRATION NO. 333-84820

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(VALERO ENERGY LOGO)

$ % NOTES DUE

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Interest payable on April and October

WE MAY REDEEM ANY OR ALL OF THE NOTES, NOTES OR NOTES AT ANY TIME AT THE REDEMPTION PRICE DESCRIBED HEREIN PLUS ACCRUED INTEREST.

INVESTING IN THE NOTES INVOLVES RISKS. SEE "RISK FACTORS" BEGINNING ON PAGE 4 OF THE ACCOMPANYING PROSPECTUS.

NOTES - PRICE % AND ACCRUED INTEREST, IF ANY
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NOTES - PRICE % AND ACCRUED INTEREST, IF ANY

	PRICE TO PUBLIC	UNDERWRITING DISCOUNTS AND COMMISSIONS	PROCEEDS TO COMPANY
Per Note....................................	%	%	%
Total...	$	$	$
Per Note....................................	%	%	%
Total...	$	$	$
Per Note....................................	%	%	%
Total...	$	$	$

The Securities and Exchange Commission and state securities regulators have not approved or disapproved these securities, or determined if this prospectus supplement or the accompanying prospectus are truthful or complete. Any representation to the contrary is a criminal offense.

The underwriters expect to deliver the notes to purchasers on April , 2002.

JOINT BOOK-RUNNING MANAGERS

MORGAN STANLEY JPMORGAN

BANC OF AMERICA LLC
BANC ONE CAPITAL MARKETS, INC.
BARCLAYS CAPITAL
BNP PARIBAS
FLEET SECURITIES, INC.
MIZUHO INTERNATIONAL PLC
RBC CAPITAL MARKETS
THE ROYAL BANK OF SCOTLAND
SCOTIA CAPITAL
SUNTRUST ROBINSON HUMPHREY
TD SECURITIES
TOKYO-MITSUBISHI INTERNATIONAL PLC

April , 2002

TABLE OF CONTENTS

You should rely only on the information contained in or incorporated into this document. We have not authorized anyone to provide you with information that is different from that contained in this document. This document is not an offer to sell securities and is not soliciting an offer to buy securities in any state where the offer or sale is not permitted. The information contained in this document is accurate only as of the date hereof, regardless of the time of delivery of this document or of any sale of securities.

SUMMARY

This summary contains basic information about us and our offering of the notes. It does not contain all the information that is important to you. You should read the following summary together with the more detailed information and financial statements and notes to the financial statements contained elsewhere or incorporated by reference in this prospectus supplement or the accompanying prospectus, as described under the heading "Information We Incorporate by Reference." To fully understand this offering, you should read all of these documents. As used in this prospectus supplement, the terms "Valero" and "we" or "us" may, depending upon the context, refer to Valero Energy Corporation, to one or more of its consolidated subsidiaries or to all of them taken as a whole.

VALERO ENERGY CORPORATION

Valero Energy Corporation is a Fortune 100 company based in San Antonio, Texas with over 22,000 employees and total assets of almost $15 billion. One of the top three U.S. refining companies in terms of refining capacity, Valero owns and operates 11 refineries in the United States and one refinery in Canada with a combined throughput capacity of about 1.9 million barrels per day (BPD). Valero's refining network stretches from eastern Canada to the U.S. Gulf Coast and West Coast. Valero produces premium, environmentally clean products, such as reformulated gasoline, gasoline meeting the specifications of the California Air Resources Board (CARB), CARB diesel fuel, low-sulfur diesel fuel and oxygenates. Valero also produces a substantial slate of conventional gasoline, distillates, jet fuel, asphalt and petrochemicals.

Valero is also a leading marketer of refined products. Valero markets branded and unbranded refined products on a wholesale basis in 40 U.S. states and Canada through an extensive bulk and rack marketing network. Valero also markets refined products and convenience store merchandise through a network of retail sites in the United States and Canada bearing the Diamond Shamrock(R), Ultramar(R), Valero(R), Beacon(R) and Total(R) brand names.

Valero also has a logistics system that complements Valero's refining and marketing assets in the U.S. Gulf Coast and Mid-Continent regions. Valero owns about 73 percent of Valero L.P., a master limited partnership that owns and operates crude oil pipelines, refined product pipelines and refined product terminals in Texas, Oklahoma, New Mexico and Colorado. Units of Valero L.P. are listed on the New York Stock Exchange under the symbol "VLI."

Valero was incorporated in Delaware in 1981 under the name Valero Refining and Marketing Company as a wholly owned subsidiary of a corporation then known as Valero Energy Corporation, and referred to in this prospectus supplement as Old Valero. Old Valero was engaged in both the refining and marketing business and the natural gas related services business. On July 31, 1997, Old Valero spun off Valero to Old Valero's stockholders by distributing to them all of the common stock of Valero. Immediately after this distribution, Old Valero, with its remaining natural gas related services business, merged with a wholly owned subsidiary of PG&E Corporation. The distribution of Valero to Old Valero's stockholders and the merger of Old Valero with the subsidiary of PG&E Corporation are collectively referred to as the "Restructuring." Upon completion of the Restructuring, Valero's name was changed from Valero Refining and Marketing Company to Valero Energy Corporation and, its common stock was listed for trading on the New York Stock Exchange.

Valero's principal executive offices are located at One Valero Place, San Antonio, Texas, 78212, and its telephone number is (210) 370-2000. Its common stock trades on the New York Stock Exchange under the symbol "VLO."

RECENT DEVELOPMENTS

Acquisition of Ultramar Diamond Shamrock Corporation. Effective December 31, 2001, Valero completed the acquisition of Ultramar Diamond Shamrock Corporation (UDS), which is referred to in this prospectus supplement as the UDS Acquisition. The consideration paid by Valero to UDS shareholders included approximately $2.1 billion in cash and approximately 45.9 million shares of Valero common stock. In connection with the acquisition, Valero assumed approximately $2 billion of UDS debt.

Prior to the acquisition, UDS was an independent refiner and retailer of refined products and convenience store merchandise in the central, southwest and northeast regions of the United States and eastern Canada. UDS owned and operated seven refineries with a combined throughput capacity of approximately 850,000 BPD. UDS marketed refined products and a broad range of convenience store merchandise through a network of approximately 4,500 convenience stores in the United States and eastern Canada.

As a condition to approval of the UDS Acquisition, the U.S. Federal Trade Commission (FTC) is requiring Valero to sell UDS's 168,000 BPD Golden Eagle Refinery located in the San Francisco Bay Area, its related wholesale marketing business and 70 associated Beacon- and Ultramar-branded retail sites in Northern California (collectively, the Golden Eagle Business). In February 2002, Valero entered into an agreement to sell the Golden Eagle Business to Tesoro Refining and Marketing Company for approximately $1.13 billion, subject to closing adjustments and certain indemnifications. The sale is expected to close in April 2002, subject to regulatory approval. The FTC has approved a trustee to manage the operations of these assets pending their sale to Tesoro.

Acquisition of Huntway Refining Company. Effective June 1, 2001, Valero completed its acquisition of Huntway Refining Company. Huntway owned and operated two California refineries at Benicia and Wilmington that produce asphalt for use in road construction and repair, primarily in California and Nevada. The facilities also produce smaller amounts of gas oil, naphtha and kerosene. These facilities have been substantially integrated into Valero's refinery systems at Benicia and Wilmington. The purchase price, net of cash acquired, was approximately $76 million and included payment to Huntway's common stockholders of $1.90 per share and amounts required to retire Huntway's outstanding debt and satisfy payment obligations under outstanding stock options.

Acquisition of El Paso Refinery and Related Product Logistics Business. Effective June 1, 2001, Valero completed its acquisition of El Paso Corporation's 115,000 BPD Corpus Christi, Texas refinery and related product logistics business through capital lease agreements that have a term of 20 years and require annual lease payments of $18.5 million for the first two years and increased amounts thereafter. The agreements also give Valero an option to purchase the facilities for approximately $294 million at the end of the second year of the lease and for increasing amounts in each succeeding year through the end of the lease term. As part of the acquisition, Valero also purchased inventories for approximately $109 million. The refinery, which is located near Valero's existing Corpus Christi Refinery, is a complex refinery that processes heavy, high-sulfur crude oil into conventional gasoline, diesel, jet fuel and other light products and petrochemicals. The product logistics facilities consist of three intrastate common carrier pipelines and related terminal facilities that enable refined products to be shipped from Corpus Christi to markets in Houston, San Antonio, Victoria and the Rio Grande Valley.

SELECTED FINANCIAL DATA

The following table sets forth selected financial data for the five years ended December 31, 2001. This information should be read in conjunction with Valero's consolidated financial statements and related notes for the years ended December 31, 2001, 2000 and 1999 included elsewhere in this prospectus supplement. This selected financial data is derived from our consolidated financial statements, which have been audited by Arthur Andersen LLP, independent public accountants.

	YEAR ENDED DECEMBER 31,				
	2001(A)(B)	2000(C)	1999	1998(D)(E)	1997(F
	(IN THOUSANDS, EXCEPT FOR RATIOS AND PER SHARE AMOUNTS)				
Operating Revenues................	$14,988,339	$14,671,087	$7,961,168	$5,539,346	$5,756,
Operating Income (Loss)...........	$1,001,343	$ 610,979	$ 72,029	$ (48,347)	$ 213,
Income (Loss) From Continuing Operations......................	$ 563,553	$ 339,120	$ 14,287	$ (47,291)	$ 111,
Loss From Discontinued Operations, Net of Income Tax Benefit(g)....	$ --	$ --	$ --	$ --	$ (15,
Net Income (Loss).................	$ 563,553	$ 339,120	$ 14,287	$ (47,291)	$ 96,
Less: Preferred stock dividend requirements and redemption premium.....................	--	--	--	--	4,
Net Income (Loss) Applicable to Common Stock...................	$ 563,553	$ 339,120	$ 14,287	$ (47,291)	$ 91,
Earnings (Loss) Per Share of Common Stock --Assuming Dilution:					
Continuing operations........	$ 8.83	$ 5.60	$ .25	$ (.84)	$ 2
Discontinued operations......	--	--	--	--	(
Total......................	$ 8.83	$ 5.60	$ .25	$ (.84)	$ 1
Ratio of Earnings to Fixed Charges(h).....................	7.3x	5.6x	1.3x	--	
Total Assets......................	$14,377,096	$ 4,307,704	$2,979,272	$2,725,664	$2,493,
Long-Term Debt (less current portion) and Capital Lease Obligations....................	$2,805,247	$ 1,042,417	$ 785,472	$ 822,335	$ 430,
Company-Obligated Preferred Securities of Subsidiary Trusts.........................	$ 372,500	$ 172,500	$ --	$ --	$

Stockholders' Equity.............	$4,202,563	$ 1,527,055	$1,084,769	$1,085,287	$1,158,

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(a) Operating revenues, operating income, income from continuing operations, net income, earnings per share and ratio of earnings to fixed charges exclude amounts related to UDS, while total assets, long-term debt (less current portion) and capital lease obligations, company-obligated preferred securities of subsidiary trusts and stockholders' equity include amounts related to UDS, which was acquired by Valero on December 31, 2001.

(b) Includes the operations of Huntway and the operations related to the El Paso Corpus Christi refinery and related product logistics business beginning June 1, 2001.

(c) Includes the operations related to the Benicia Refinery and the related distribution assets (Distribution Assets) beginning May 16, 2000 and the operations related to the service stations included as part of the acquisition from ExxonMobil (Service Stations) beginning June 16, 2000 (combined, the Benicia Acquisition).

(d) Includes the operations of the Paulsboro Refinery beginning September 17, 1998.

(e) The 1998 operating loss includes a $170.9 million write-down of inventories to market value, which resulted in a $111.1 million reduction in net income, or $1.98 per share.

(f) Includes the operations of the Texas City, Houston and Krotz Springs refineries beginning May 1, 1997.

(g) Reflects the results of the natural gas related services business of Old Valero for periods prior to the July 31, 1997 Restructuring, which resulted in the creation of Valero.

(h) Computed by dividing earnings by fixed charges. For this purpose, earnings consist of consolidated income from continuing operations before income taxes and fixed charges (excluding capitalized interest), with certain other adjustments. Fixed charges consist of total interest, whether expensed or capitalized, including amortization of debt expense and premiums or discounts related to outstanding indebtedness, one-third (the proportion deemed representative of the interest factor) of rental expense and distributions on preferred securities of a subsidiary trust which are deducted in the determination of consolidated pre-tax income from continuing operations. For the year ended December 31, 1998, earnings were insufficient to cover fixed charges by $77.7 million. This deficiency was due primarily to the $170.9 million pre-tax charge to earnings to write down the carrying amount of refinery inventories to market value described above in note (e). Excluding the effect of the inventory write-down, the ratio of earnings to fixed charges would have been 2.7x.

THE OFFERING

Notes Offered.............................	$ in principal amount of % Notes due .
	$ in principal amount of % Notes due .
	$ in principal amount of % Notes due .

Maturity Date.............................	Notes -- Notes -- Notes --
Interest Payment Dates.....................	April and October , beginning on October , 2 Interest will accrue from the issue date of the not
Ranking....................................	The notes are unsecured senior obligations of Valer will rank pari passu with all other unsecured senio indebtedness of Valero.
Optional Redemption........................	We may redeem some or all of the notes at any time the redemption price described in the "Description the Notes" section under the heading "Optional Redemption," plus accrued interest to the date of redemption.
Covenants..................................	The indenture governing the notes contains covenant that, with certain exceptions, limit our ability an subsidiaries' ability to: - incur debt secured by liens; and - engage in sale/leaseback transactions. For more details, see the section under the heading "Description of Debt Securities -- Restrictive Cove nants in the Senior Indenture" in the accompanying prospectus.
Use of Proceeds............................	We will use the proceeds of the notes to reduce outstanding indebtedness under our $1.5 billion bri loan facility.
Risk Factors...............................	You should carefully consider all information set f and incorporated by reference in this prospectus supplement and, in particular, should carefully rea section entitled "Risk Factors" in the accompanying prospectus before purchasing any of the Notes.

S-6

USE OF PROCEEDS

We estimate that the proceeds (after deducting underwriting discounts and commissions and estimated offering expenses) we will receive from this offering will be approximately $ billion.

The cash portion of the UDS Acquisition was funded with $1.5 billion in borrowings under a bridge loan facility, which currently bears interest at a rate of LIBOR plus 1% and matures on December 13, 2002, and approximately $555 million in borrowings under revolving bank credit facilities, which also currently bear interest at a rate of LIBOR plus 1%. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources" for more information on these credit facilities.

We anticipate using the net proceeds of this offering to repay borrowings under the bridge loan facility discussed above. Affiliates of each of the underwriters are lenders under the bridge loan facility. Valero will pay a portion of the proceeds of this offering to these affiliates of the underwriters when Valero repays the bridge loan facility. See "Underwriting" for further discussion.

CAPITALIZATION

The following table sets forth our capitalization (which includes our consolidated subsidiaries) as of December 31, 2001 on an historical basis and as adjusted to (i) reflect borrowings in January 2002 under the bridge loan and revolving bank credit facilities for the purpose of paying the cash consideration to UDS shareholders in connection with the UDS Acquisition, (ii) reflect this offering and the application of the net proceeds from this offering as described under "Use of Proceeds" and (iii) give effect to the sale of the Golden Eagle Business and the application of the proceeds to pay down debt and repurchase common stock, as described under "Unaudited Pro Forma Combined Financial Statements." This table should be read in conjunction with our historical consolidated financial statements beginning on page F-2 of this prospectus supplement.

	DECEMBER 31, 2001		
	HISTORICAL	PRO FORMA ADJUSTMENTS	PRO F AS ADJ
		(IN THOUSANDS)	
Short-term debt:			
Short-term bank credit facility	$ 200,000	$ --	$ 200
Bank bridge loan facility, $1.5 billion	--	1,500,000(1) ( )(2)	
Revolving bank credit facility, 364-day, $750 million	--	555,250(1) (555,250)(3)	
Total short-term debt	200,000		
Current portion of long-term debt	305,661	--	305
Payable to UDS shareholders	2,055,250	(2,055,250)(1)	
Long-term debt, less current portion	2,517,398	(179,750)(3)	2,33
Notes offered hereby	--	(2)	
Capital lease obligations	287,849	--	287
Company-obligated preferred securities of subsidiary trusts	372,500	--	372
Minority interest in consolidated partnership	115,608	--	115
Stockholders' equity:			
Common stock, $0.01 par value; 300,000,000 shares authorized; 108,198,992 shares issued	1,082	--	1
Additional paid-in capital	3,468,550	--	3,468
Retained earnings	864,421	--	864
Accumulated other comprehensive income	18,126	--	18
Treasury stock, at cost; 4,001,683 shares; 12,892,548 shares as adjusted for the repurchase of shares with proceeds from the sale of the Golden Eagle Business	(149,616)	(400,000)(3)	(54

Total stockholders' equity........................	4,202,563	(400,000)	3,802
Total capitalization..............................	$10,056,829	$	$

See notes on following page.

(1) To reflect the payment in January 2002 of the cash consideration to UDS shareholders in connection with the UDS Acquisition, recorded as a payable as of December 31, 2001, using borrowings of $1.5 billion under the bridge loan facility and approximately $555.3 million under the revolving bank credit facilities. For purposes of the capitalization table, we are assuming the $555.3 million was borrowed under the 364-day revolving bank credit facility.

(2) To reflect the anticipated use of the expected net proceeds of this offering to repay borrowings under the $1.5 billion bridge loan facility.

(3) Assuming that the issuance of notes pursuant to this offering, as described in note 2 above, has already occurred, this transaction reflects the anticipated use of the expected proceeds from the sale of the Golden Eagle Business to repay $735 million of bank borrowings and repurchase $400 million of our common stock at an assumed price per share of $44.99 (approximately 8.9 million shares). During December 2001, approximately $100 million of our common stock was repurchased as part of our plan to repurchase a total of $500 million of our common stock using anticipated proceeds from the sale of the Golden Eagle Business.

UNAUDITED PRO FORMA COMBINED FINANCIAL STATEMENTS

On December 31, 2001, Valero completed the UDS Acquisition. As a condition to regulatory approval of the UDS Acquisition, the FTC approved a consent decree requiring Valero to divest the Golden Eagle Business. In February 2002, Valero reached a definitive agreement to sell the Golden Eagle Business for approximately $1.13 billion.

The following unaudited pro forma combined statement of income combines the historical consolidated statements of income of Valero and UDS, giving effect to the acquisition using the purchase method of accounting. The unaudited pro forma combined statement of income assumes that:

-- the UDS Acquisition was effected on January 1, 2001;

-- Valero issued approximately 45.9 million shares of common stock and paid approximately $2.1 billion of cash to UDS shareholders; and

-- the proceeds from the sale of the Golden Eagle Business are used to pay down approximately $635 million of debt and repurchase $500 million of Valero common stock (approximately 11.1 million shares).

The unaudited pro forma combined statement of income does not reflect anticipated synergies or costs and charges that may result from the acquisition. For purposes of this unaudited pro forma combined statement of income, the purchase price was allocated to the individual assets acquired and liabilities assumed based on preliminary estimates of fair values, pending the completion of an independent appraisal and other evaluations. The accounting policies of Valero and UDS are substantially comparable. However, certain historical amounts of UDS have been reclassified to conform the financial statement presentation of the two companies.

This unaudited pro forma combined financial information should be read in conjunction with the historical consolidated financial statements of Valero and UDS included in this prospectus supplement beginning on page F-1. The pro forma adjustments use estimates and assumptions based on currently available information. Management believes that the estimates and assumptions are reasonable, and that the significant effects of the acquisition are properly reflected. However, this pro forma information is not intended to be indicative of the historical results that would have been achieved had the companies always been combined or the results of operations which may be achieved in the future.

VALERO ENERGY CORPORATION

UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 2001
(MILLIONS OF DOLLARS, EXCEPT PER SHARE AMOUNTS)

	VALERO HISTORICAL	UDS HISTORICAL	PRO FORMA ADJUSTMENTS	VALERO AND UDS COMBINED
Operating revenues	$14,988.3	$16,860.0	$(2,020.6)(a) (2,664.2)(b) (482.3)(c)	$26,681.2
Costs and expenses:				
Cost of sales and operating expenses	13,684.1	15,211.3	(1,759.9)(a) (2,664.2)(b) (482.3)(c)	23,989.0
Selling and administrative expenses	165.2	415.0	(15.3)(a) (18.4)(d)	546.5
Goodwill amortization	--	20.0	(5.3)(a) (14.7)(e)	--
Depreciation expense	137.7	232.8	(37.3)(a) (20.1)(f)	313.1
Total costs and expenses	13,987.0	15,879.1	(5,017.5)	24,848.6
Operating income (loss)	1,001.3	980.9	(149.6)	1,832.6
Other income (expense), net	(4.6)	.5	(0.4)(a)	(4.5)
Interest and debt expense:				
Incurred	(99.1)	(110.9)	(137.4)(g) (3.0)(g) 42.5(h) .9(h)	(307.0)
Capitalized	10.6	4.8	--	15.4
Distributions on preferred securities of subsidiary trusts	(13.3)	(17.2)	--	(30.5)
Minority interest in net income of consolidated partnership	--	(9.4)	--	(9.4)

Income (loss) before income taxes.........	894.9	848.7	(247.0)	1,496.6
Income tax expense (benefit)..............	331.3	313.7	(82.9)(a) (13.0)(i)	549.1
Net income (loss).........................	$ 563.6	$ 535.0	$ (151.1)	$ 947.5
Earnings per share of common stock........	$ 9.28	$ 7.22		$ 9.92
Weighted average common shares outstanding (in millions)............	60.7	74.1		95.5(j
Earnings per share of common stock--assuming dilution................	$ 8.83	$ 7.08		$ 9.47
Weighted average common equivalent shares outstanding (in millions).....	63.8	75.5		100.1(j

See Notes to Unaudited Pro Forma Combined Financial Statements.

VALERO ENERGY CORPORATION

NOTES TO UNAUDITED PRO FORMA COMBINED STATEMENT OF INCOME

(a) To exclude the results of operations related to the Golden Eagle Business that are included in the UDS historical results, as the Golden Eagle Business is assumed to have been sold as of January 1, 2001.

(b) To exclude excise taxes of $2,664.2 million (the amount remaining after excluding the taxes eliminated as part of the Golden Eagle Business) collected on behalf of governmental agencies associated with UDS' operations from Operating Revenues and Cost of Sales to conform to Valero's accounting policies.

(c) To eliminate intercompany sales of $482.3 million from Operating Revenues and Cost of Sales.

(d) To eliminate certain UDS nonrecurring transaction costs of $18.4 million directly attributable to the acquisition that were expensed by UDS.

(e) To reverse UDS' historical goodwill amortization.

(f) To record a $20.1 million decrease in UDS' depreciation expense based on the preliminary purchase price allocation and estimated useful lives.

(g) To reflect interest expense of $137.4 million at a weighted average annual interest rate of 6.6875% on borrowings of $2.1 billion required to fund the UDS Acquisition and $3.0 million of amortization of related debt issuance costs. A 1/8% change in the interest rate associated with these borrowings would have a $2.6 million effect on interest expense for the year ended December 31, 2001.

(h) To reflect a reduction in interest expense of $42.5 million and a $.9 million reduction in amortization of related debt issuance costs resulting from the assumed paydown of $635 million of debt with part of the proceeds from the sale of the Golden Eagle Business. A 1/8% change in the interest rate associated with this reduction in borrowings would have a $.8 million effect on interest expense for the year ended December 31, 2001.

(i) To reflect the tax effect of the pro forma pre-tax income adjustments related to the UDS Acquisition and adjust the effective tax rate to the rate that would have been incurred by Valero with respect to the assets acquired.

(j) The weighted average shares used to compute pro forma earnings per share reflect the issuance of 45.9 million shares to effect the acquisition, reduced by 11.1 million shares repurchased with part of the proceeds from the disposition of the Golden Eagle Business.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following selected review of the results of operations and financial condition of Valero is taken from "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Valero's Form 10-K for the year ended December 31, 2001. This selected review is not complete. For a more complete review of the results of operations and financial condition of Valero you should refer to "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" in Valero's Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference. The following selected review of the results of operations and financial condition of Valero should be read in conjunction with "Business" and our consolidated financial statements included elsewhere in this prospectus supplement. All references to Consolidated Balance Sheets, Consolidated Statements of Income and Notes to Consolidated Financial Statements pertain to Valero's consolidated financial statements and related notes for the year ended December 31, 2001 found on pages F-2 through F-60. In the discussions that follow, all "per share" amounts assume dilution.

ACQUISITION OF ULTRAMAR DIAMOND SHAMROCK CORPORATION

On December 31, 2001, Valero completed its acquisition of UDS (the UDS Acquisition) after the Federal Trade Commission (FTC) approved a consent decree on December 19 allowing the acquisition to be completed. In connection with the UDS Acquisition, Valero issued approximately 45.9 million shares of common stock and paid approximately $2.1 billion of cash to UDS shareholders. UDS was an independent refiner and retailer of refined products and convenience store merchandise in the central, southwest and northeast regions of the United States and eastern Canada. UDS owned and operated seven refineries, including two in Texas, two in California and one each in Oklahoma, Colorado, and Quebec, Canada, with a combined throughput capacity of approximately 850,000 barrels per day. UDS marketed refined products and a broad range of convenience store merchandise through a network of approximately 4,500 convenience stores under the Diamond Shamrock(R), Beacon(R), Ultramar(R), and Total(R) brand names in the United States and eastern Canada. UDS's northeast retail operations also included the marketing of refined products through 86 cardlocks, which are card- or key-activated, self-service, unattended stations that allow commercial, trucking and governmental fleets to buy gasoline and diesel fuel 24 hours a day, and a retail home heating oil business that sells heating oil to approximately 250,000 households. As a condition for the regulatory approval of the acquisition, the FTC's consent decree requires Valero to divest the 168,000 barrel-per-day Golden Eagle Refinery located in the San Francisco Bay Area, the related wholesale marketing business and 70 associated Beacon- and Ultramar-branded retail sites located throughout Northern California (collectively, the Golden Eagle Business). On February 4, 2002, Valero entered into a definitive agreement with Tesoro Refining and Marketing Company (Tesoro), which was subsequently amended on February 20, 2002, under which Tesoro will purchase the Golden Eagle Business for approximately $1.13 billion, subject to closing adjustments and certain indemnifications. The transaction is expected to close in April 2002, subject to regulatory approval. See Notes 2, 3 and 27 of Notes to Consolidated Financial Statements for additional information about the acquisition and the assets required to be divested and their expected sale to Tesoro.

RESULTS OF OPERATIONS

2001 COMPARED TO 2000

FINANCIAL HIGHLIGHTS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2001(A)(B)	2000(C)	AMOUNT	%
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
Operating revenues	$14,988,339	$14,671,087	$317,252	2
Cost of sales	(12,738,607)	(13,076,849)	338,242	3
Operating costs:				
Cash (fixed and variable)	(852,155)	(682,742)	(169,413)	(25
Depreciation and amortization	(222,411)	(164,008)	(58,403)	(36
Selling and administrative expenses (including related depreciation expense)	(173,823)	(136,509)	(37,314)	(27
Total operating income	1,001,343	610,979	390,364	64
Other income (expense), net	(4,613)	282	(4,895)	--
Interest and debt expense, net	(88,508)	(76,245)	(12,263)	(16
Distributions on preferred securities of subsidiary trust	(13,369)	(6,796)	(6,573)	(97
Income tax expense	(331,300)	(189,100)	(142,200)	(75
Net income	$ 563,553	$ 339,120	$224,433	66
Earnings per share of common stock--assuming dilution	$ 8.83	$ 5.60	$ 3.23	58
Earnings before interest, taxes, depreciation and amortization (EBITDA)(e)	$1,235,005	$ 785,744	$449,261	57
Ratio of EBITDA to interest incurred(e)	11.0x	8.7x	2.3x	26

(a) Excludes amounts related to UDS which was acquired by Valero on December 31, 2001.

(b) Includes the operations of Huntway and the operations related to the El Paso Corpus Christi refinery and related product logistics business beginning June 1, 2001.

(c) Includes the operations related to the Benicia Refinery and the related distribution assets (Distribution Assets) beginning May 16, 2000 and the operations related to the service stations included as part of the acquisition from ExxonMobil (Service Stations) beginning June 16, 2000 (combined, the Benicia Acquisition).

(d) Percentage variance is greater than 100%.

(e) For purposes of this calculation, distributions on preferred securities of subsidiary trust are included in interest incurred.

OPERATING HIGHLIGHTS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2001(A)(B)	2000(C)	AMOUNT	%
Sales volumes (thousand barrels per day or MBPD)	1,355	1,142	213	19%
Throughput volumes (MBPD)	1,001	857	144	17
Average throughput margin per barrel	$ 6.16	$ 5.08	$1.08	21
Operating costs per barrel:				
Cash (fixed and variable)	$ 2.31	$ 2.18	$ .13	6
Depreciation and amortization	.61	.52	.09	17
Total operating costs per barrel	$ 2.92	$ 2.70	$ .22	8
Charges:				
Crude oils:				
Sour	62%	55%	7%	13
Heavy sweet	4	8	(4)	(50)
Light sweet	7	8	(1)	(13)
Total crude oils	73	71	2	3
High-sulfur residual fuel oil (resid)	4	4	--	--
Low-sulfur resid	4	3	1	33
Other feedstocks and blendstocks	19	22	(3)	(14)
Total charges	100%	100%	--%	--
Yields:				
Gasolines and blendstocks	53%	53%	--%	--
Distillates	27	28	(1)	(4)
Petrochemicals	3	3	--	--
Lubes and asphalts	4	3	1	33
Other products	13	13	--	--
Total yields	100%	100%	--%	--

AVERAGE MARKET REFERENCE PRICES AND DIFFERENTIALS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2001	2000	AMOUNT	%
	(DOLLARS PER BARREL)			

Feedstocks (at U.S. Gulf Coast, except as noted):				
West Texas Intermediate (WTI) crude oil(d)................	$25.93	$30.36	$(4.43)	(15)%
WTI less sour crude oil(e)(f)............................	$ 5.01	$ 3.52	$1.49	42
WTI less Alaska North Slope (ANS) crude oil (U.S. West Coast)(d)..	$ 2.69	$ 2.04	$ .65	32
WTI less sweet crude oil(g)()............................	$ (.23)	$ (.49)	$ .26	53
Products:				
U.S. Gulf Coast:				
Conventional 87 gasoline less WTI(d)..................	$ 5.07	$ 4.66	$ .41	9
No. 2 fuel oil less WTI(d)............................	$ 3.01	$ 3.60	$(.59)	(16)
Propylene less WTI(h).................................	$ (.83)	$ 4.88	$(5.71)	--(i)
U.S. East Coast:				
Conventional 87 gasoline less WTI(d)..................	$ 5.05	$ 5.62	$(.57)	(10)
No. 2 fuel oil less WTI(d)............................	$ 3.83	$ 5.73	$(1.90)	(33)
Lube oils less WTI(f)(j)..............................	$26.83	$17.31	$9.52	55
U.S. West Coast:				
CARB 87 gasoline less ANS(d)..........................	$16.04	$14.74	$1.30	9
Low-sulfur diesel less ANS(d).........................	$ 9.05	$10.63	$(1.58)	(15)

See notes on following page.

(a) Excludes amounts related to UDS which was acquired by Valero on December 31, 2001.

(b) Includes the operations of Huntway and the operations related to the El Paso Corpus Christi refinery and related product logistics business beginning June 1, 2001.

(c) Includes the operations related to the Benicia Refinery and the Distribution Assets beginning May 16, 2000 and the operations related to the Service Stations beginning June 16, 2000.

(d) Based on posted prices from Platts, the energy information and market services unit of The McGraw-Hill Companies.

(e) The market reference differential for sour crude oil is based on posted prices for 50% Arab medium and 50% Arab light crude oils from Petroleum Argus, a global independent source of oil and gas pricing information.

(f) The market reference differential for the 2000 period has been restated from the amount reported in Valero's Form 10-K for the year ended December 31, 2000 to conform to the components used in the 2001 period.

(g) The market reference differential for sweet crude oil is based on Platts posted prices for 50% light Louisiana sweet (LLS) and 50% Cusiana crude oils, with LLS adjusted for backwardation.

(h) Based on posted prices from Chemical Marketing Associates, Inc. (CMAI), a consulting service for the worldwide petrochemical, plastics, fibers and chlor-alkali industries.

(i) Percentage variance is greater than 100%.

(j) Based on posted prices for ExxonMobil lube oils from ICIS-LOR, a pricing information service for the petrochemical and oil markets.

General. Valero reported net income of $563.6 million, or $8.83 per share, for the year ended December 31, 2001 compared to net income of $339.1 million, or $5.60 per share, for the year ended December 31, 2000. For the fourth quarter of 2001, Valero reported net income of $51.6 million, or $.82 per share, compared to net income of $93.3 million, or $1.47 per share, for the fourth quarter of 2000. The increase in total year results was due in part to the full year contribution from the Benicia Acquisition which was completed in the second quarter of 2000. Excluding the effect of the Benicia Acquisition, total year results increased as a result of a substantial increase in throughput margins due primarily to a significant improvement in sour crude oil discounts, higher throughput volumes resulting largely from the acquisitions of the El Paso and Huntway refineries in June 2001 and upgrades to the crude units at the Texas City Refinery in February 2001, and an $8.8 million pre-tax, or $.09 per share after-tax, benefit attributable to the acquisition of UDS inventories on December 31, 2001 as discussed in Note 6 of Notes to Consolidated Financial Statements. Partially offsetting the increase in throughput margins for Valero's operations excluding Benicia were higher operating costs and selling and administrative expenses, and an increase in income tax expense.

Results for the fourth quarter of 2001 declined from fourth quarter 2000 levels due primarily to a decrease in distillate and gasoline margins attributable to exceptionally high margins experienced in the 2000 period and higher industry-wide inventories in the 2001 period, and increases in operating costs, depreciation expense and interest expense. Partially offsetting the decrease in income resulting from these factors were higher throughput volumes as described above, the processing of a larger percentage of sour crude oil, the above-noted benefit attributable to the December 31, 2001 acquisition of UDS inventories, and decreases in selling and administrative expenses and income tax expense.

Operating Revenues. Operating revenues increased $317.3 million, or 2%, to $15.0 billion during 2001 compared to 2000 due primarily to a 19% increase in average daily sales volumes, offset to a large extent by a $4.81, or 14%, decrease in the average sales price per barrel. The increase in average daily sales volumes was due primarily to (i) the full year effect of volumes attributable to the Benicia Acquisition, (ii) an increase in the sale of feedstocks and products purchased for resale, and (iii) higher throughput volumes resulting from the contribution of the El Paso and Huntway refineries acquired in the second quarter of 2001 and capacity expansions at the Texas City and other refineries during 2001. The decrease in average sales prices was due primarily to lower refined product prices resulting from increased refined product inventories industry-wide and a decrease in crude oil prices. The increase in refined product inventory levels was attributable primarily to (i) increased production and higher imports of gasoline which more than offset improved demand, (ii) unusually low distillate inventories in 2000 and (iii) a weakened economy following the terrorist attacks on September 11, 2001.

Operating Income. Operating income increased $390.4 million, or 64%, to $1.0 billion during 2001 compared to 2000 due in part to the above-noted full year contribution from the Benicia Acquisition which

resulted in an increase in operating income of approximately $67 million. Excluding the effect of the Benicia Acquisition, operating income increased due to an approximate $472 million increase in total throughput margins (operating revenues less cost of sales), partially offset by an approximate $122 million increase in operating costs (including an $80 million increase in cash operating costs and a $42 million increase in depreciation and amortization expense), and an approximate $27 million increase in selling and administrative expenses (including related depreciation expense).

Total throughput margins, excluding the effect of the Benicia Acquisition, increased due to (i) the effect of higher throughput volumes resulting from the factors noted above in the discussion of operating revenues, including a significant increase in the volume of Valero's sour crude oil charges during 2001 to take advantage of higher sour crude oil discounts discussed below, (ii) higher per barrel feedstock discounts, particularly for sour crude oil resulting primarily from an increase in supplies of heavier crude oil while demand for sweeter crude oil increased to meet lower sulfur requirements for certain refined products, (iii) higher lube oil margins resulting mainly from improved market conditions, (iv) higher prices for No. 6 fuel oil and other heavy products relative to crude oil prices, and (v) the pre-tax benefit attributable to the December 31, 2001 acquisition of UDS inventories noted above under "General." Partially offsetting the increases in total throughput margins resulting from these factors were (i) lower distillate margins, when compared to exceptionally high margins in 2000, due to strong demand and extremely low industry inventory levels in 2000 resulting from cold weather and high natural gas prices which caused power producers to switch to fuel oil to run their plants, (ii) a significant decrease in margins for propylene and other petrochemical feedstocks, to negative levels in 2001, due to slowing economic activity throughout the world, and (iii) an increase in natural gas, hydrogen and methanol feedstock costs relative to crude oil.

Cash operating costs were higher due primarily to the operations of the Corpus Christi refinery and related product logistics business acquired from El Paso in 2001 and increases in employee salaries, benefits and variable compensation, maintenance costs, and ad valorem taxes, partially offset by reduced refinery energy costs. Depreciation and amortization expense was higher due primarily to an increase in turnaround and catalyst amortization and increased depreciation expense resulting from the 2001 acquisition of the El Paso facilities and capital expansion projects. Selling and administrative expenses (including related depreciation expense) increased primarily as a result of an increase in employee salaries, benefits and variable compensation, and integration and early retirement costs incurred in 2001 in connection with the UDS Acquisition. Partially offsetting these increases in selling and administrative expenses was the nonrecurrence in 2001 of costs recorded in 2000 associated with certain litigation and other matters.

Other Income (Expense), Net. Other income (expense), net, decreased $4.9 million, from income of $.3 million during 2000 to expense of $4.6 million during 2001, due to reduced results from Valero's 20% equity interest in the Javelina off-gas processing plant in Corpus Christi attributable primarily to higher natural gas feedstock costs and lower product prices resulting from a weak petrochemical market. Partially offsetting the reduced results from the Javelina plant were lower costs related to the agreement entered into by Valero in September 1999 to sell a portion of its accounts receivable.

Net Interest and Debt Expense. Net interest and debt expense increased $12.3 million, or 16%, to $88.5 million in 2001 compared to 2000 due primarily to a full year of interest in 2001 on borrowings incurred to fund the Benicia Acquisition, including interest on the senior notes issued in June 2000, and interest recognized in connection with the capital lease obligations associated with the June 1, 2001 El Paso acquisition, partially offset by a decrease in bank borrowings resulting from Valero's strong earnings and cash flow.

Distributions on Preferred Securities of Subsidiary Trust. Distributions on preferred securities of subsidiary trust increased from $6.8 million in 2000 to $13.4 million in 2001 due to a full year of distributions on the PEPS Units issued in June 2000 in connection with funding the Benicia Acquisition. See Notes 2 and 13 of Notes to Consolidated Financial Statements.

Income Tax Expense. Income tax expense increased from $189.1 million in

2000 to $331.3 million in 2001 due primarily to the significant increase in pre-tax income. See Note 19 of Notes to Consolidated Financial Statements.

2000 COMPARED TO 1999

FINANCIAL HIGHLIGHTS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2000(A)	1999	AMOUNT	%
	(DOLLARS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)			
Operating revenues	$ 14,671,087	$ 7,961,168	$ 6,709,919	84%
Cost of sales	(13,076,849)	(7,206,903)	(5,869,946)	(81)
Operating costs:				
Cash (fixed and variable)	(682,742)	(473,787)	(208,955)	(44)
Depreciation and amortization	(164,008)	(135,764)	(28,244)	(21)
Selling and administrative expenses (including related depreciation expense)	(136,509)	(72,685)	(63,824)	(88)
Total operating income	610,979	72,029	538,950	--(b
Other income, net	282	3,587	(3,305)	(92)
Interest and debt expense, net	(76,245)	(55,429)	(20,816)	(38)
Distributions on preferred securities of subsidiary trust	(6,796)	--	(6,796)	--(b
Income tax expense	(189,100)	(5,900)	(183,200)	--(b
Net income	$ 339,120	$ 14,287	$ 324,833	--(b
Earnings per share of common stock--assuming dilution	$ 5.60	$ .25	$ 5.35	--(b
Earnings before interest, taxes, depreciation and amortization (EBITDA)(c)	$ 785,744	$ 216,769	$ 568,975	--(b
Ratio of EBITDA to interest incurred(c)	8.7x	3.5x	5.2x	--(b

(a) Includes the operations related to the Benicia Refinery and the Distribution Assets beginning May 16, 2000 and the operations related to the Service Stations beginning June 16, 2000.

(b) Percentage variance is greater than 100%.

(c) For purposes of this calculation, distributions on preferred securities of subsidiary trust are included in interest incurred.

OPERATING HIGHLIGHTS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2000(A)	1999	AMOUNT	%
Sales volumes (MBPD)	1,142	1,033	109	11%
Throughput volumes (MBPD)	857(b)	712	145	20
Average throughput margin per barrel	$ 5.08	$ 2.90	$2.18	75
Operating costs per barrel:				
Cash (fixed and variable)	$ 2.18	$ 1.83	$ .35	19
Depreciation and amortization	.52	.52	--	--
Total operating costs per barrel	$ 2.70	$ 2.35	$ .35	15
Charges:				
Crude oils:				
Sour	55%	48%	7%	15
Heavy sweet	8	12	(4)	(33)
Light sweet	8	9	(1)	(11)
Total crude oils	71	69	2	3
High-sulfur resid	4	3	1	33
Low-sulfur resid	3	6	(3)	(50)
Other feedstocks and blendstocks	22	22	--	--
Total charges	100%	100%	--%	--
Yields:				
Gasolines and blendstocks	53%	51%	2%	4
Distillates	28	29	(1)	(3)
Petrochemicals	3	5	(2)	(40)
Lubes and asphalts	3	3	--	--
Other products	13	12	1	8
Total yields	100%	100%	--%	--

AVERAGE MARKET REFERENCE PRICES AND DIFFERENTIALS

	YEAR ENDED DECEMBER 31,			
			CHANGE	
	2000	1999	AMOUNT	%
	(DOLLARS PER BARREL)			
Feedstocks (at U.S. Gulf Coast, except as noted):				
WTI crude oil(c)	$30.36	$19.28	$11.08	57%
WTI less sour crude oil(d)(e)	$ 3.52	$ 2.40	$1.12	47
WTI less ANS (U.S. West Coast)(c)(f)	$ 2.04	$ 1.55	$ .49	32
WTI less sweet crude oil(g)	$ (.49)	$ (.06)	$(.43)	--(h)
Products:				
U.S. Gulf Coast:				
Conventional 87 gasoline less WTI(c)	$ 4.66	$ 2.53	$2.13	84
No. 2 fuel oil less WTI(c)	$ 3.60	$ .33	$3.27	--(h)
Propylene less WTI(i)	$ 4.88	$ .93	$3.95	--(h)

U.S. East Coast:				
Conventional 87 gasoline less WTI(c)	$ 5.62	$ 3.47	$2.15	62
No. 2 fuel oil less WTI(c)	$ 5.73	$ 1.16	$4.57	--(h)
Lube oils less WTI(e)(j)	$17.31	$12.51	$4.80	38
U.S. West Coast(f):				
CARB less ANS(c)	$14.74	$12.13	$2.61	22
Low-sulfur diesel less ANS(c)	$10.63	$ 6.86	$3.77	55

See notes on following page.

(a) Includes the operations related to the Benicia Refinery and the Distribution Assets beginning May 16, 2000 and the operations related to the Service Stations beginning June 16, 2000.

(b) Includes 106 MBPD for 2000 related to the Benicia Refinery.

(c) Based on Platts posted prices.

(d) The market reference differential for sour crude oil is based on Petroleum Argus posted prices for 50% Arab Medium and 50% Arab light crude oils.

(e) The market reference differentials for the 2000 and 1999 periods have been restated from the amounts reported in Valero's Form 10-K for the year ended December 31, 2000 to conform to the components used in the 2001 period.

(f) The market reference differentials for the U.S. West Coast are total year differentials presented for informational purposes only. The comparison is not relevant to Valero since the Benicia Acquisition did not occur until the second quarter of 2000.

(g) The market reference differential for sweet crude oil is based on Platts posted prices for 50% LLS and 50% Cusiana crude oils, with LLS adjusted for backwardation.

(h) Percentage variance is greater than 100%.

(i) Based on CMAI posted prices.

(j) Based on ICIS-LOR posted prices for ExxonMobil lube oils.

General. Valero reported net income of $339.1 million, or $5.60 per share, for the year ended December 31, 2000 compared to net income of $14.3 million, or $.25 per share, for the year ended December 31, 1999. For the fourth quarter of 2000, Valero reported net income of $93.3 million, or $1.47 per share, compared to net income of $16.5 million, or $.29 per share, for the fourth quarter of 1999. The substantial increase in full year results was due primarily to dramatically improved refining industry fundamentals which resulted in a significant increase in throughput margins, and the contribution from the Benicia Acquisition ($1.80 per share) completed in the second quarter of 2000. Also contributing to higher full year results was the effect in the first quarter of 1999 of a major maintenance turnaround of the heavy oil cracker and related units at the Corpus Christi Refinery, as well as certain unit expansions implemented during that downtime, which both reduced results for 1999 and increased results for 2000. Partially offsetting the increases in net income resulting from these factors for Valero's operations excluding Benicia were higher cash operating costs and selling and administrative expenses, an increase in income tax expense, the effect of certain scheduled and unscheduled refinery downtime experienced primarily during the 2000 second quarter, and the nonrecurrence in 2000 of benefits to income in 1999 related to reductions in LIFO inventories.

Results for the fourth quarter of 2000 increased from fourth quarter 1999 levels due primarily to the significant contribution from the Benicia Acquisition ($.71 per share) and substantially higher throughput margins for Valero's operations excluding Benicia resulting from exceptionally strong refining industry fundamentals and higher throughput volumes in the 2000 quarter. Partially offsetting the increase in throughput margins for Valero's operations excluding Benicia were increases in cash operating costs, including substantially higher natural gas costs, selling and administrative expenses, and income tax expense.

Operating Revenues. Operating revenues increased $6.7 billion, or 84%, to $14.7 billion during 2000 compared to 1999 due to a $13.88, or 66%, increase in the average sales price per barrel and an 11% increase in average daily sales volumes. The increase in average sales prices was due primarily to significantly higher refined product prices resulting from reduced refined product inventories industry-wide and an increase in crude oil prices. The decline in refined product inventory levels was attributable primarily to (i) lower crude oil supplies resulting from the continued impact of OPEC's decision in March 1999 to significantly reduce crude oil production, (ii) lower refinery utilization rates in late 1999 and early 2000, (iii) reduced refinery production due to more stringent fuel specifications in the U.S. and Europe that became effective in 2000, and (iv) improved demand for distillates. Average daily sales volumes increased due primarily to additional volumes attributable to the Benicia Acquisition.

Operating Income. Operating income increased $539 million, from $72 million in 1999 to $611 million in 2000, due in part to the contribution from the Benicia Acquisition noted above. Excluding the effect of the Benicia Acquisition, operating income increased due to an approximate $471 million increase in total

S-20

throughput margins, partially offset by an approximate $99 million increase in cash operating costs and an approximate $49 million increase in selling and administrative expenses (including related depreciation expense).

Total throughput margins, excluding the effect of the Benicia Acquisition, increased due to (i) significantly higher distillate margins resulting primarily from strong demand and extremely low industry inventory levels, (ii) higher gasoline margins resulting primarily from supply constraints and low industry inventories, (iii) improved feedstock discounts for sour crude oil resulting primarily from increases in sour crude oil production by OPEC and a shift in demand from sour crude oil to sweet crude oil due to lower sulfur requirements for certain refined products, (iv) higher RFG premiums and oxygenate margins due to improved demand and the tightening of fuel specifications in the U.S. and Europe noted above, (v) significantly higher lube oil margins resulting mainly from improved market conditions, (vi) higher petrochemical margins resulting from improved worldwide demand, particularly in Asia, and (vii) higher throughput volumes. The strong demand for distillate noted above was attributable mainly to cold weather and high natural gas prices. These high natural gas prices caused various power producers to switch to fuel oil to run their plants, which also served to further reduce distillate inventories. Partially offsetting the increases in total throughput margins resulting from the above factors were (i) lower prices for No. 6 fuel oil and other heavy products relative to crude oil prices, (ii) an increase in sweet crude oil costs to amounts in excess of WTI, (iii) the effect of scheduled and unscheduled refinery downtime experienced primarily during the 2000 second quarter, (iv) a decrease in gains from trading activities and (v) the nonrecurrence in 2000 of benefits resulting from the liquidation of LIFO inventories in the first and fourth quarters of 1999 of $10.5 million and $9.3 million, respectively.

Cash operating costs were higher due primarily to higher fuel and electricity costs attributable mainly to an increase in natural gas prices, an increase in employee salaries, benefits and variable compensation, and higher maintenance costs related primarily to certain unscheduled refinery downtime, tank cleanings and lower than normal maintenance activities in 1999. Selling and administrative expenses (including related depreciation expense) increased primarily as a result of an increase in employee salaries, benefits, variable compensation and other employee-related costs, and costs associated with litigation and other matters.

Other Income, Net. Other income, net, decreased $3.3 million to $.3 million during 2000 compared to 1999 due primarily to increased costs in 2000 related to the agreement entered into by Valero in September 1999 to sell a portion of its accounts receivable, partially offset by improved results of $2.6 million from Valero's 20% equity interest in the Javelina off-gas processing plant in Corpus Christi. The increase in Javelina's results was attributable primarily to significantly higher prices for natural gas liquids and increases in prices for ethylene and other products, partially offset by significantly higher natural gas feedstock costs.

Net Interest and Debt Expense. Net interest and debt expense increased $20.8 million, or 38%, to $76.2 million during 2000 compared to 1999 due primarily to increased borrowings to fund the Benicia Acquisition, including the issuance of the senior notes in June 2000 and borrowings under Valero's bank credit facilities (the effects of which are included in the $1.80 per share contribution from the Benicia Acquisition noted above), partially offset by a paydown of bank borrowings during 2000 resulting from Valero's strong earnings and cash flow.

Income Tax Expense. Income tax expense increased from $5.9 million in 1999 to $189.1 million in 2000 due primarily to the significant increase in pre-tax income. See Note 19 of Notes to Consolidated Financial Statements.

OUTLOOK

OVERVIEW

The economy continued to weaken throughout 2001 and the decline was accelerated by the terrorist attacks on the U.S. on September 11, 2001. Following September 11th, refined product demand declined, particularly for jet fuel, and distillate and gasoline inventories started building. An unusually mild winter, coupled with the weak economy, contributed to further weakening of refined product demand, which resulted

in a further build-up of refined product inventories. To compensate for the decreasing demand for crude oil, OPEC cut crude oil production, primarily sour crudes, which has resulted in a significant narrowing of the sour crude discount to WTI.

FIRST QUARTER 2002

Through February 2002, refining margins are 40 to 50 percent below refining margins in the first quarter of 2001. Average gasoline margins remain well below the exceptionally high levels seen during the first quarter of 2001, due primarily to above-average inventory levels, which resulted from high production levels, increased imports and the blending of various petrochemicals into the gasoline pool. For example, through February 2002, average Gulf Coast gasoline margins relative to WTI were approximately $2.45 per barrel, compared to average first quarter 2001 margins of $5.76 per barrel. Through February 2002, average West Coast gasoline margins relative to ANS were also weak due to high inventory levels resulting from West Coast refineries maintaining relatively high production rates. The West Coast gasoline margin has averaged $9.70 per barrel through February 2002, well below average first quarter 2001 margins of $19.47 per barrel. Average distillate margins through February 2002 are much lower than those seen in the first quarter of 2001 as a result of the mild winter and weak economy as discussed above, and reduced demand for jet fuel (which is causing an increase in distillate inventories). For example, average Gulf Coast distillate margins relative to WTI have declined to $1.36 per barrel thus far in 2002 compared to average first quarter 2001 margins of $3.47 per barrel. Average margins for other products, including lube oil and propylene, have also declined thus far in 2002, primarily due to lower demand caused by the weak economy.

Retail fuel margins have also been under pressure in the first quarter of 2002 due to various factors, including significant discounting by major retailers in an effort to capture market share and increased competition from large discount marketers of gasoline.

With respect to feedstocks, the lower OPEC production of sour crude oils discussed above has resulted in average discounts for sour crude oil narrowing substantially in the first quarter of 2002 from the very strong first quarter 2001 levels. Sour crude oil discounts to WTI (defined as an average of Arab Light and Arab Medium delivered to the U.S. Gulf Coast) averaged $2.28 per barrel through February 2002 compared to $5.33 per barrel in the first quarter 2001.

Valero's refinery utilization rates for the first quarter of 2002 are expected to be below historical levels due to heavy turnaround activity, various unscheduled downtimes, and economic-based run cuts as a result of poor margins. Based on current plans, Valero's crude oil run cuts are expected to amount to approximately 23% of total crude capacity for the first quarter, inclusive of turnarounds. During the first quarter of 2002, Valero will have six of its 12 refineries involved in major turnaround activities at various times and for varying durations. Most of the refinery units scheduled to be down during these turnarounds are conversion units, which are the primary gasoline making units in a refinery. The six refineries in turnaround include the Corpus Christi, Benicia, Three Rivers, McKee, Ardmore and Krotz Springs refineries. In addition, the Texas City Refinery will undergo a major turnaround in April 2002.

As a result of the poor product margins experienced thus far in 2002, the substantial narrowing of sour crude discounts due to OPEC production cuts, and significantly lower refinery utilization rates, Valero currently expects to incur a slight loss in the first quarter of 2002.

REMAINDER OF 2002 AND BEYOND

Industry Fundamentals

For the remainder of 2002, Valero anticipates, based on projected supply and demand fundamentals, that refining margins should strengthen. Refinery utilization rates have remained low throughout the first quarter of 2002. In addition to Valero's heavy turnaround activity and announced run cuts described above, industry consultants have indicated that first quarter refinery turnarounds will be heavy throughout the industry, and other refiners have also announced significant levels of economic-based run cuts this quarter, especially of crude units. Considering these lower refinery utilization rates coupled with lower OPEC crude oil production,

inventories should decline from first quarter 2002 levels. In addition, the economy is showing signs of recovery, with commodity prices rising, manufacturing activity increasing, and consumer confidence improving. As the economy continues its recovery, the supply and demand balance should tighten leading to lower refined product inventories, improved margins and positive earnings going forward.

In the four weeks ending March 1, 2002, gasoline demand was 490,000 BPD or approximately 6% higher than the same period last year, due primarily to relatively low pump prices and more consumers opting to drive rather than fly. Gasoline demand is expected to further strengthen as the summer driving season approaches, given the effect of low pump prices on demand, many consumers opting to drive rather than fly this summer and the impact of the recovering economy on consumer sentiment. It is also encouraging to note that, despite the high inventory levels, days supply of gasoline is currently the same as last year. However, gasoline margins will likely continue under pressure until excess inventories are reduced.

Distillate demand is down 4.7% through February 2002 compared to the first two months of 2001 due to the mild winter and weak economy as described above. As a result, distillate inventories are approximately 20 million barrels above normal. Distillate margins will remain weak until inventories are reduced to more normal levels. Reduced distillate production due to economic-based run cuts by the industry, and an improving economy, should help reduce excess inventories.

Valero believes that beyond 2002, refined product margins will improve due to continued tightening fuel specifications and improving economic conditions throughout the world. Refined product supply and demand balances are expected to tighten in the U.S., Europe and Asia from the combined effect of increasing demand, more stringent gasoline specifications, and refinery closures (resulting from increased capital requirements to meet the increasingly stringent fuel specifications). In fact, the impact of these fundamental changes to the industry is already being seen in the U.S. by the closure last year of the 85,000 barrel-per-day Blue Island Refinery in the Midwest and the recent announcement of the closure later this year of another Midwest refinery that produces 70,000 barrels per day of refined products. The impact of refinery closures and the volumetric impact caused by tighter fuel specifications should more than offset refinery capacity additions and the limited amount of new refinery construction that is underway around the world.

New product pipeline projects, including the Centennial pipeline that connects the Gulf Coast to the Midwest and the Longhorn pipeline that connects the Gulf Coast to El Paso, Texas, will change the dynamics of regional refined product pricing in the U.S. The increased refined product supply capability will tend to mitigate the upside volatility of refined product margins in the Midwest and in the West Texas/New Mexico markets, and should also improve the Gulf Coast margins as more refined products are delivered away from the Gulf Coast region. Certain higher-cost, inefficient refiners in the Midwest and in the West Texas/New Mexico markets may be forced to shut down if they cannot reduce their costs to remain competitive.

Over the next several years, Valero expects the production of heavy sour crude will exceed that of light sweet crude by an increasing amount, which should result in widening discounts for Valero's purchases of sour crude oils. As the world economy strengthens, demand for crude oil is expected to increase. As OPEC increases its crude oil production levels to meet this demand, the incremental sour crude barrels that were taken off the market will be the first barrels brought back to the market to meet increasing demand. Additionally, new discoveries of sour and heavy reserves are rapidly coming to the market from areas such as deepwater Gulf of Mexico, the former Soviet Union and Canada. In some major regions such as the North Sea, light sweet crude production is already declining. With demand for sweet and light crude oils continuing to be strong due to the implementation in 2000 of lower sulfur requirements in products and the increasing availability of sour crude oil versus sweet crude oil, the price differential between sweet crude oil and sour crude oil should increase. Beginning in 2004, the further tightening of fuel specifications will also increase the demand for light, sweet crude, further contributing to wider light sweet/heavy sour price differentials. Valero expects to recognize significant benefits from its ability to meet current fuel specifications using predominantly sour crude oil feedstocks as the supply of sour crude and the demand for sweet crude continue to increase in the future. In addition, Valero expects that an improving world economy would cause crude oil demand to improve which would widen the sour crude discount, thereby significantly benefiting Valero.

Capital Investments

During 2001, Valero added more than 900,000 barrels per day of throughput capacity to its refining operations, acquired an extensive logistics business to enhance its business operations and became one of the nation's largest retailers, primarily through the UDS Acquisition on December 31, 2001. Currently, Valero's primary focus is to capture the synergy opportunities that the UDS Acquisition creates. Beyond 2002, Valero plans to implement projects to increase the amount of heavy sour crude processed at the UDS refineries.

For 2002, Valero currently expects to incur approximately $1 billion for capital investments, including approximately $840 million for capital expenditures (approximately $165 million of which is for environmental projects) and approximately $160 million for deferred turnaround and catalyst costs. The capital expenditure estimate excludes approximately $100 million and $35 million, respectively, related to a delayed coker facility at the Texas City Refinery and the planned expansion of the UDS headquarters facility for future use as Valero's new corporate headquarters, which are being funded through structured lease arrangements (see Notes 23 and 27 of Notes to Consolidated Financial Statements). The capital expenditure estimate also excludes anticipated expenditures related to the earn-out contingency agreements described in Note 2 of Notes to Consolidated Financial Statements. The estimate of deferred turnaround and catalyst costs includes the costs of major maintenance turnarounds planned for the remainder of 2002 at the Corpus Christi, Texas City and Paulsboro refineries, which are expected to enhance the profitability of these refineries going forward.

As refining margins merit, Valero expects to continue making capital investments at its refineries to enhance feedstock flexibility, meet low sulfur gasoline and distillate requirements, meet other environmental requirements of both the EPA and various state agencies, make improvements in throughput capacity, and enhance the operational efficiency and mechanical reliability of its operations. Typically, these capital improvements would be implemented during scheduled maintenance turnarounds.

Valero also plans to continue its program of modernizing and upgrading its convenience store network through its re-imaging program. Over the past several years, UDS has re-imaged 130 sites. Valero plans to continue this program and is currently evaluating the entire network of UDS convenience stores to determine the appropriate branding, the number of sites and the timetable for upgrading the network.

Industry Consolidation

Significant industry consolidation through mergers and acquisitions has occurred in the past and is continuing. Valero expects that industry consolidations will continue, providing Valero with possible additional opportunities to expand its operations. Geographically, that growth will most likely come in the Northeast, Mid-Continent and Gulf Coast regions. Valero is well positioned to capitalize on further industry consolidation opportunities and to benefit from these long-term industry trends.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities increased $304.2 million to $905.5 million during 2001 compared to 2000, due primarily to the significant increase in net income discussed above under "Results of Operations," partially offset by an increase in the amount of cash used to fund working capital. During 2001, approximately $1.1 billion of cash was generated from earnings, approximately $181.1 million of which was used for other operating activities, primarily working capital requirements. During 2001, there were significant changes in individual components of working capital, as detailed in "Statements of Cash Flows" in Note 16 of Notes to Consolidated Financial Statements. Accounts payable decreased $237.6 million and accounts receivable decreased $122.1 million primarily due to a decline in various commodity prices from December 2000 to December 2001, partially offset by an increase in volumes purchased and sold. Accounts payable also declined due to Valero's redelivery to the U.S. Strategic Petroleum Reserve in 2001 of approximately one million barrels of crude oil in settlement of a time exchange of crude oil entered into in 2000. During 2001, cash provided by operating activities, issuances of common stock in connection with Valero's benefit plans, and proceeds from the disposition of property, plant and equipment were utilized to (i) fund capital expenditures, deferred turnaround and catalyst costs and the earn-out contingency payments to Salomon Inc

and ExxonMobil described in Note 2 of Notes to Consolidated Financial Statements, (ii) fund the acquisition of Huntway and inventories related to the acquisition of El Paso's Corpus Christi refinery and related product logistics business, (iii) repurchase shares of Valero common stock, and (iv) pay common stock dividends.

Valero's cash flows from operations are primarily affected by the relationship, or margins, between refined product prices and the prices for crude oil and other feedstocks. Historically, refining margins have been volatile, and they are likely to continue to be volatile in the future. Based on results thus far in 2002 and margin estimates for the remainder of the year, operating cash flows for 2002 are expected to be significantly below 2001 levels.

As discussed in Note 2 of Notes to Consolidated Financial Statements, the $2.1 billion cash portion of the UDS Acquisition was financed with proceeds from a $1.5 billion bridge loan facility and borrowings under two new $750 million revolving bank credit facilities. The bridge loan facility, which is a single-draw facility, has a one-year maturity. Proceeds from the required disposition of the Golden Eagle Refinery and associated retail assets must be used to pay down any amounts then outstanding under the bridge facility and reduce commitments thereunder. The two revolving bank credit facilities provide for commitments of $750 million for a five-year term and $750 million for a 364-day term, respectively, and replace Valero's previous $835 million revolving bank credit and letter of credit facility. Borrowings under these facilities bear interest at either the London interbank offered rate (LIBOR) plus a margin, a base rate or a money market rate. The interest rate and fees under these credit facilities are subject to adjustment based upon the credit ratings assigned to Valero's long-term debt. The credit facilities include certain restrictive covenants including a coverage ratio and a debt-to-capitalization ratio. As of December 31, 2001, borrowings under the two revolving credit facilities were $525 million, while letters of credit outstanding were approximately $145 million. Valero also currently has an uncommitted short-term bank credit facility, along with various uncommitted bank letter of credit facilities. As of December 31, 2001, $200 million was outstanding under the short-term bank credit facility, and letters of credit totaling approximately $92 million were outstanding under the uncommitted letter of credit facilities.

As of December 31, 2001, Valero's committed revolving credit facilities also consisted of a Canadian facility under which a Canadian subsidiary may borrow, issue bankers' acceptances and obtain letters of credit in an aggregate amount of Cdn. $200 million, and a U.S. facility under which Valero L.P. may borrow up to $120 million, both of which were assumed in the UDS Acquisition. Valero must pay annual fees on the total used and unused portion of these revolving credit facilities. The interest rate under these facilities floats based upon the prime rate, LIBOR or other floating interest rates, at Valero's option. As of December 31, 2001, there were no amounts outstanding under the Canadian facility and $16 million was outstanding under the Valero L.P. facility.

As of December 31, 2001, Valero had outstanding $150 million principal amount of 6 3/4% notes, under which a third party has an option to purchase the notes under certain circumstances at par on December 15, 2002. If the third party does not exercise its purchase option, Valero would be required to repurchase the notes at par on December 15, 2002. Valero currently expects that the third party will exercise its purchase option, in which case the term of the notes would be extended to December 15, 2032.

The following table presents Valero's commercial bank commitments and the amount of commitment expiration per period as of December 31, 2001 (in thousands). Valero had no guarantees or standby repurchase obligations as of December 31, 2001.

		AMOUNT OF COMMITMENT EXPIRATION PER PERIOD			
COMMERCIAL BANK COMMITMENTS	TOTAL AMOUNTS COMMITTED	LESS THAN 1 YEAR	1-3 YEARS	4-5 YEARS	OVER 5 YEARS
Lines of credit.............	$3,449,845	$2,579,845	$ --	$870,000	$--
Standby letters of credit....	144,735	110,032	34,687	--	16

As discussed in Note 5 of Notes to Consolidated Financial Statements, Valero, through a wholly owned subsidiary, has an agreement, which matures in September 2002, with a third party financial institution to sell,

S-25

on a revolving basis, up to $100 million of eligible trade accounts receivable. Also, in connection with the UDS Acquisition, Valero assumed a $360 million revolving accounts receivable sales facility, maturing in December 2002, whereby Valero can sell, on an ongoing basis, eligible credit card and trade accounts receivable through a wholly owned subsidiary to a third party financial institution. Under these agreements, the subsidiaries sell an undivided percentage ownership interest in the eligible receivables, without recourse, to the third party financial institutions which maintain at all times a 3% equity interest in their undivided interest in the receivables. Valero's retained interest in these receivables is included in "Receivables, net" on the Consolidated Balance Sheets and is recorded at fair value. Valero remains responsible for servicing the transferred receivables and pays certain fees related to its sale of receivables under these programs. During 2001, 2000 and 1999, the costs incurred by Valero related to its pre-existing program, which are included in "Other income (expense), net" in the Consolidated Statements of Income and exclude costs related to the program assumed in the UDS Acquisition, were $2.3 million, $6.8 million and $1.6 million, respectively. As of December 31, 2001, the amount of eligible receivables sold to the third party financial institutions under these programs was $373 million.

Under common stock repurchase programs approved by Valero's Board of Directors, Valero repurchases shares of its common stock from time to time for use in connection with its employee benefit plans and other general corporate purposes. During 2001, Valero repurchased shares of its common stock under these programs at a cost of $156.7 million. Through February 2002, Valero has repurchased additional common shares under these programs at a cost of approximately $6.4 million.

Dividends on Valero's common stock are considered quarterly by Valero's Board of Directors, are determined by the Board on the basis of earnings and cash flows, and may be paid only when approved by the Board. Through the third quarter of 2001, Valero declared a dividend of $.08 per common share for each quarter since the July 1997 Restructuring. On October 18, 2001, Valero's Board of Directors approved an increase in Valero's regular quarterly cash dividend on common stock from $.08 per common share to $.10 per common share.

Valero believes it has sufficient funds from operations, and to the extent necessary, from the public and private capital markets and bank markets, to fund its ongoing operating requirements. During the first quarter of 2002, Valero filed a $3.5 billion universal shelf registration statement with the SEC and with this offering is issuing approximately $ billion of notes with varying maturities. The proceeds are expected to be used to reduce borrowings under the $1.5 billion bridge loan facility. Valero expects that, to the extent necessary, it can raise additional funds from time to time through equity or other debt financings. However, there can be no assurances regarding the availability of any future financings or whether such financings can be made available on terms acceptable to Valero.

Valero's refining and marketing operations have a concentration of customers in the petroleum refining industry and petroleum products markets. These concentrations of customers may impact Valero's overall exposure to credit risk, either positively or negatively, in that these customers may be similarly affected by changes in economic or other conditions. However, Valero believes that its portfolio of accounts receivable is sufficiently diversified to the extent necessary to minimize potential credit risk. Historically, Valero has not had any significant problems collecting its accounts receivable.

BUSINESS

The following selected review of the business of Valero is taken from "Items 1. & 2. Business & Properties" in Valero's Form 10-K for the year ended December 31, 2001. This selected review is not complete. For a more complete review of the business of Valero you should refer to "Items 1. & 2. Business &

Properties" in Valero's Form 10-K for the year ended December 31, 2001, which is incorporated herein by reference.

Valero Energy Corporation is a Fortune 100 company based in San Antonio, Texas with over 22,000 employees and total assets of almost $15 billion. One of the top three U.S. refining companies in terms of refining capacity, Valero owns and operates 11 refineries in the United States and one refinery in Canada with a combined throughput capacity of about 1.9 million barrels per day (BPD). Valero's refining network stretches from eastern Canada to the U.S. Gulf Coast and West Coast. Valero produces premium, environmentally clean products, such as reformulated gasoline (RFG), gasoline meeting the specifications of the California Air Resources Board (CARB), CARB diesel fuel, low-sulfur diesel fuel and oxygenates. Valero also produces a substantial slate of conventional gasoline, distillates, jet fuel, asphalt and petrochemicals.

Valero is also a leading marketer of refined products. Valero markets branded and unbranded refined products on a wholesale basis in 40 U.S. states and Canada through an extensive bulk and rack marketing network. Valero also markets refined products and convenience store merchandise through a network of retail sites in the United States and Canada bearing the Diamond Shamrock(R), Ultramar(R), Valero(R), Beacon(R) and Total(R) brand names.

Valero also has a logistics system that complements Valero's refining and marketing assets in the U.S. Gulf Coast and Mid-Continent regions. Valero owns about 73 percent of Valero L.P., a master limited partnership that owns and operates crude oil pipelines, refined product pipelines and refined product terminals in Texas, Oklahoma, New Mexico and Colorado. Units of Valero L.P. are listed on the New York Stock Exchange under the symbol "VLI."

Valero was incorporated in Delaware in 1981 under the name Valero Refining and Marketing Company as a wholly owned subsidiary of a corporation then known as Valero Energy Corporation, and referred to in this prospectus supplement as Old Valero. Old Valero was engaged in both the refining and marketing business and the natural gas related services business. On July 31, 1997, Old Valero spun off Valero to Old Valero's stockholders by distributing to them all of the common stock of Valero. Immediately after this distribution, Old Valero, with its remaining natural gas related services business, merged with a wholly owned subsidiary of PG&E Corporation. The distribution of Valero to Old Valero's stockholders and the merger of Old Valero with the subsidiary of PG&E Corporation are collectively referred to as the "Restructuring." Upon completion of the Restructuring, Valero's name was changed from Valero Refining and Marketing Company to Valero Energy Corporation and its common stock was listed for trading on the New York Stock Exchange.

Valero's principal executive offices are located at One Valero Place, San Antonio, Texas, 78212, and its telephone number is (210) 370-2000. Its common stock trades on the New York Stock Exchange under the symbol "VLO."

All references to Notes to Consolidated Financial Statements pertain to the notes to Valero's consolidated financial statements for the year ended December 31, 2001 found on pages F-8 through F-60 of this prospectus supplement.

RECENT DEVELOPMENTS

Acquisition of Ultramar Diamond Shamrock Corporation. Effective December 31, 2001, Valero completed the merger of Ultramar Diamond Shamrock Corporation (UDS) into Valero Energy Corporation, with Valero Energy Corporation as the surviving corporation. We refer to this transaction as the UDS Acquisition. Under the terms of the merger agreement dated May 6, 2001, each outstanding share of UDS common stock, other than treasury shares (which were cancelled) and shares in employee benefit plans (which were converted directly into Valero common stock), was converted into the right to receive, at the shareholder's election but subject to proration, either (i) cash, (ii) a number of shares of Valero common stock, or (iii) a combination of cash and Valero stock, in each case having a value equal to the sum of $27.50

and .614 shares of Valero common stock (valued at the average closing Valero common stock price over a ten trading-day period ending three days prior to the merger). Merger consideration paid by Valero to UDS shareholders included approximately $2.1 billion in cash and approximately 45.9 million shares of Valero common stock (based on an average Valero stock price of $35.78 during the measurement period).

UDS was an independent refiner and retailer of refined products and convenience store merchandise in the central, southwest and northeast regions of the United States and eastern Canada. UDS owned and operated seven refineries, including two in Texas, two in California and one each in Oklahoma, Colorado and Quebec, Canada, with a combined throughput capacity of approximately 850,000 BPD. UDS marketed refined products and a broad range of convenience store merchandise through a network of approximately 4,500 convenience stores in the United States and eastern Canada under the brand names Diamond Shamrock(R), Beacon(R), Ultramar(R) and Total(R). UDS's Northeast operations also included a retail home heating oil business.

As a condition to approval of the UDS Acquisition, the U.S. Federal Trade Commission (FTC) is requiring Valero to sell UDS's 168,000 BPD Golden Eagle Refinery located in the San Francisco Bay Area, its related wholesale marketing business and 70 associated Beacon- and Ultramar-branded retail sites in Northern California (collectively, the Golden Eagle Business). In February 2002, Valero entered into an agreement to sell the Golden Eagle Business to Tesoro Refining and Marketing Company (Tesoro) for approximately $1.13 billion, subject to closing adjustments and certain indemnifications. The sale is expected to close in April 2002, subject to regulatory approval. The FTC has approved a trustee to manage the operations of these assets pending their sale to Tesoro. See Notes 2, 3 and 27 of Notes to Consolidated Financial Statements.

Acquisition of Huntway Refining Company. Effective June 1, 2001, Valero completed its acquisition of Huntway Refining Company. Huntway owned and operated two California refineries at Benicia and Wilmington that produce asphalt for use in road construction and repair, primarily in California and Nevada. The facilities also produce smaller amounts of gas oil, naphtha and kerosene. These facilities have been substantially integrated into Valero's refinery systems at Benicia and Wilmington. The purchase price, net of cash acquired, was approximately $76 million and included payment to Huntway's common stockholders of $1.90 per share and amounts required to retire Huntway's outstanding debt and satisfy payment obligations under outstanding stock options.

Acquisition of El Paso Refinery and Related Product Logistics Business. Effective June 1, 2001, Valero completed its acquisition of El Paso Corporation's 115,000 BPD Corpus Christi, Texas refinery and related product logistics business through capital lease agreements that have a term of 20 years and require annual lease payments of $18.5 million for the first two years and increased amounts thereafter. The agreements also give Valero an option to purchase the facilities for approximately $294 million at the end of the second year of the lease and for increasing amounts in each succeeding year through the end of the lease term. As part of the acquisition, Valero also purchased inventories for approximately $109 million. The refinery, which is located near Valero's existing Corpus Christi Refinery, is a complex refinery that processes heavy, high-sulfur crude oil into conventional gasoline, diesel, jet fuel and other light products and petrochemicals. The product logistics facilities consist of three intrastate common carrier pipelines and related terminal facilities that enable refined products to be shipped from Corpus Christi to markets in Houston, San Antonio, Victoria and the Rio Grande Valley.

VALERO'S OPERATIONS

Valero's primary reportable business segments are refining and retail. Valero's refining segment includes refinery, wholesale marketing, product supply and distribution, and transportation operations. The refining segment is segregated geographically into the Gulf Coast, Mid-Continent, West Coast and Northeast regions. Valero's retail segment includes company-operated convenience stores, Canadian dealers/jobbers, truckstop facilities, cardlock and home heating oil operations. The retail segment is also segregated geographically. Valero's retail operations in the northeastern United States and eastern Canada are referred to as the

Northeast System, and Valero's remaining retail operations in the United States are referred to as the US System. See Note 20 of Notes to Consolidated Financial Statements for additional segment information.

REFINING, WHOLESALE MARKETING AND FEEDSTOCK SUPPLY

Refining

Valero's refining operations include 12 refineries with a combined total throughput capacity of approximately 1.9 million BPD. The following table lists the location of each of Valero's refineries and its respective feedstock throughput capacity. The table excludes the Golden Eagle Refinery, which is being sold.

REFINERY	LOCATION	THROUGHPUT CAPACITY(a) (BARRELS PER DAY)
GULF COAST:		
Corpus Christi	Texas	340,000
Texas City	Texas	240,000
Houston	Texas	135,000
Three Rivers	Texas	98,000
Krotz Springs	Louisiana	85,000
		898,000
WEST COAST:		
Benicia	California	180,000
Wilmington	California	140,000
		320,000
MID-CONTINENT:		
McKee	Texas	170,000
Ardmore	Oklahoma	85,000
Denver	Colorado	27,000
		282,000

NORTHEAST:		
Quebec	Quebec, Canada	205,000
Paulsboro	New Jersey	195,000
		400,000
TOTAL		1,900,000

(a) Throughput capacity includes crude oil, intermediates and other feedstocks. Total crude oil capacity is approximately 1,526,000 BPD.

Gasolines represent approximately 52 percent of Valero's refined product slate, and distillates--such as home heating oil, diesel and jet fuel--represent approximately 30 percent; asphalt, lubricants, petrochemicals and other heavy products comprise the remaining 18 percent. Of the gasoline that Valero produces, about 45 percent is produced as reformulated gasoline and CARB gasoline, which sell at a premium over conventional grades of gasoline. Over 75 percent of Valero's distillate slate is CARB diesel, low-sulfur diesel and jet fuel, which sell for a premium over high-sulfur heating oil.

Gulf Coast

Valero's Gulf Coast refining region includes the Corpus Christi Refinery, the Texas City Refinery, the Houston Refinery, the Three Rivers Refinery and the Krotz Springs Refinery. The following table shows representative percentages of the principal feedstock charges and product yields for the five refineries in this region for 2002.

COMBINED GULF COAST REGION FEEDSTOCKS AND PRODUCTS
PROJECTED FOR 2002

	PERCENTAGE
Feedstocks:	
sour crude	54 %
sweet crude	22 %
residual fuel oil	9 %
other feedstocks and blendstocks	15 %
Products:	
gasoline & blendstocks	50 %
Distillates	30 %
Petrochemicals	5 %
lubes and asphalts	2 %
other products	13 %

Corpus Christi Refinery. The Corpus Christi Refinery is located along the Corpus Christi Ship Channel on the Texas Gulf Coast. The refinery is composed of two plants, Valero's flagship West Plant and the recently acquired East Plant. The West Plant is a highly complex refinery that specializes in processing primarily lower-cost sour crude oil and residual fuel oil (resid) into premium products such as RFG and CARB gasoline. Valero has substantially integrated the operations of the West Plant and the East Plant allowing for the transfer of various feedstocks and blending components between the plants and the sharing of resources. The refinery typically receives and delivers its feedstocks and products by tanker and barge via deep-water docking facilities along the Corpus Christi Ship Channel. In addition, the refinery has an eight-bay truck rack for servicing local markets and uses the Colonial, Explorer and other major pipelines--including its own pipelines--for distribution of its products.

Texas City Refinery. The Texas City Refinery is located approximately 40 miles southeast of Houston on the Texas City Ship Channel. As a result of improvements Valero made to this refinery since its acquisition in 1997, the Texas City Refinery processes primarily lower-cost sour crudes into a wide slate of products. A 45,000 BPD delayed coking unit and related facilities are being constructed at the refinery which are expected to be operational in early 2004. The refinery typically receives and delivers its feedstocks and products by tanker and barge via deep-water docking facilities along the Texas City Ship Channel and also has access to the Colonial, Explorer and TEPPCO pipelines for distribution of its products.

Houston Refinery. The Houston Refinery is located on the Houston Ship Channel. The refinery typically receives its feedstocks via tanker at deep-water docking facilities along the Houston Ship Channel. The refinery primarily delivers its products through major product pipelines, including the Colonial, Explorer and TEPPCO pipelines.

Three Rivers Refinery. The Three Rivers Refinery is located in South Texas near Corpus Christi. The Three Rivers Refinery has access to crude oil from foreign sources delivered to the Texas Gulf Coast at Corpus Christi as well as crude oil from domestic sources through third-party pipelines. The Three Rivers Refinery and the Corpus Christi Refinery are connected by a 70-mile pipeline that can deliver 120,000 BPD of crude oil. Valero distributes refined products produced at this refinery primarily through pipelines owned by Valero L.P.

Krotz Springs Refinery. The Krotz Springs Refinery is located approximately halfway between Baton Rouge and Lafayette, Louisiana on the Atchafalaya River. The refinery's location provides access to upriver markets on the Mississippi River, and its docking facilities along the Atchafalaya River are sufficiently deep to allow barge access. The facility also uses the Colonial pipeline to transport products to markets in the Southeast and Northeast.

West Coast

Valero's West Coast refining region includes the Benicia Refinery and the Wilmington Refinery. The following table shows representative percentages of the principal feedstock charges and product yields for the two refineries in this region for 2002.

COMBINED WEST COAST REGION FEEDSTOCKS AND PRODUCTS
PROJECTED FOR 2002

	PERCENTAGE
Feedstocks:	
sour crude	77%
sweet crude	0%
residual fuel oil	0%

other feedstocks and blendstocks	23%
Products:	
gasoline & blendstocks	64%
distillates	23%
petrochemicals	0%
lubes and asphalts	2%
other products	11%

Benicia Refinery. The Benicia Refinery is located northeast of San Francisco on the Carquinez Straits of San Francisco Bay. It is a highly complex refinery that processes sour crude oils into a high percentage of premium products, primarily CARB gasoline. The refinery can receive crude supplies via a deep-water dock that can berth large crude carriers and a 20-inch crude pipeline connected to a southern California crude delivery system. Most of the refinery's products are distributed via the Kinder Morgan pipeline in California.

Wilmington Refinery. The Wilmington Refinery is located near Los Angeles, California. The refinery processes a blend of lower-cost heavy and high-sulfur crude oils. The refinery can produce all of its gasoline as CARB gasoline. The refinery is connected by pipeline to marine terminals and associated dock facilities that can move and store crude oil and other feedstocks. Refined products are distributed via a third-party pipeline and terminals in southern California, Nevada and Arizona.

S-31

Mid-Continent

Valero's Mid-Continent refining region includes the McKee Refinery, the Ardmore Refinery and the Denver Refinery. The following table shows representative percentages of the principal feedstock charges and product yields for the three refineries in this region for 2002.

COMBINED MID-CONTINENT REGION FEEDSTOCKS AND PRODUCTS
PROJECTED FOR 2002

	PERCENTAGE
Feedstocks:	
sour crude	20%
sweet crude	75%
residual fuel oil	0%
other feedstocks and blendstocks	5%
Products:	
gasoline & blendstocks	56%
distillates	29%
petrochemicals	3%
lubes and asphalts	7%
other products	5%

McKee Refinery. The McKee Refinery is located in the Texas panhandle. The McKee Refinery has access to crude oil from Texas, Oklahoma, Kansas and Colorado through crude oil pipelines owned or leased by Valero and through third-party pipelines. The refinery also has access at Wichita Falls, Texas to third-party pipelines that transport crude oil from the Texas Gulf Coast and West Texas oil fields to the Mid-Continent region. The refinery distributes its products via pipeline to markets in North Texas, New Mexico, Arizona, Colorado and Oklahoma.

Ardmore Refinery. The Ardmore Refinery is located in Ardmore, Oklahoma, approximately 90 miles from Oklahoma City. Crude oil is delivered to the refinery through Valero's crude oil gathering and trunkline systems, third-party pipelines and trucking operations. Refined products are transported via pipelines, rail cars and trucks.

Denver Refinery. The Denver Refinery is located outside Denver, Colorado. Crude oil for the refinery is supplied by a third-party pipeline and by truck. The refinery benefits from a refined product pipeline that runs to and from the McKee Refinery, which enhances flexibility in operations at both refineries.

Northeast

Valero's Northeast refining region includes the Quebec Refinery in Quebec, Canada and the Paulsboro Refinery in New Jersey. The following table shows representative percentages of the principal feedstock charges and product yields for the two refineries in this region for 2002.

COMBINED NORTHEAST REGION FEEDSTOCKS AND PRODUCTS
PROJECTED FOR 2002

	PERCENTAGE
Feedstocks:	
sour crude	66%
sweet crude	27%
residual fuel oil	0%
other feedstocks and blendstocks	7%
Products:	
gasoline & blendstocks	41%
distillates	40%
petrochemicals	3%
lubes and asphalts	6%
other products	10%

Quebec Refinery. Valero's Quebec Refinery is located in Quebec, Canada on the St. Lawrence River. The refinery receives crude oil by ship at its deep-water dock on the St. Lawrence River and can receive year-round shipments of crude oil from large crude oil tankers. Valero charters large crude oil tankers that can navigate the St. Lawrence River year-round. The refinery's production is transported primarily by unit trains to markets in Montreal and New Brunswick, and by tankers and trucks to markets in Canada's Atlantic provinces.

Paulsboro Refinery. The Paulsboro Refinery is located in Paulsboro, New Jersey approximately 15 miles south of Philadelphia on the Delaware River. The refinery processes primarily sour crudes into a wide slate of products including gasoline, distillates, a variety of lube oil basestocks, asphalt and fuel oil. Feedstocks and refined products are typically transported by tanker and barge via refinery-owned dock facilities along the Delaware River, ExxonMobil's product distribution system, an onsite truck rack and the Colonial pipeline, which allows products to be sold into the New York Harbor market.

Wholesale Marketing

Valero is a leading wholesale marketer of branded and unbranded refined products. Valero markets on a wholesale basis in 40 U.S. states and Canada primarily through an extensive bulk and rack marketing network. Valero markets branded refined products under the Diamond Shamrock(R), Ultramar(R), Valero(R), Beacon(R), Total(R) and Exxon(R) brand names.

Valero's bu