Fuel Excellence

PETRON
Fuel Success

Petron Corporation

Fuel Success

Leadership
Commitment
Partnerships

Vision Mission Values

"To be the Leading Provider of Total Customer Solutions in the Energy Sector and its Derivative Businesses." We will achieve this by:

- Being an integral part of our customers' lives, delivering a consistent customer experience thru innovative products and services;
- Developing strategic partnerships in pursuit of growth and opportunity;
- Leveraging our refining assets to achieve competitive advantage;
- Fostering an entrepreneurial culture that encourages teamwork, innovation, and excellence;
- Caring for our community and environment;
- Conducting ourselves with professionalism, integrity and fairness;
- Promoting the best interest of all our stakeholders.

Our Cover **Story**

Committed to a single vision, Petron harnesses the abilities of many to accomplish our goal. We encourage excellent performance. We exceed customer expectations. We set standards. We deliver innovations. We satisfy with passion.

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Company **Profile**

Petron Corporation is the largest oil refining and marketing company in the Philippines. Supplying more than a third of the country's oil requirements, our world-class products and quality services fuel the lives of millions of Filipinos. We are dedicated and passionate about our vision to be the leading provider of total customer solutions in the energy sector and its derivative businesses.

We operate a refinery in Limay, Bataan, with a rated capacity of 180,000 barrels a day. Our ISO-14001-certified refinery processes crude oil into a full range of petroleum products including LPG, gasoline, diesel, jet fuel, kerosene, industrial fuel oil, solvents, asphalts, and mixed xylene.

From the refinery, we move our products mainly by sea to 32 depots and terminals situated all over the country. Through this nationwide network, we supply fuel oil, diesel, and LPG to various industrial customers. The power sector is our largest customer.

We also supply jet fuel at key airports to international and domestic carriers.

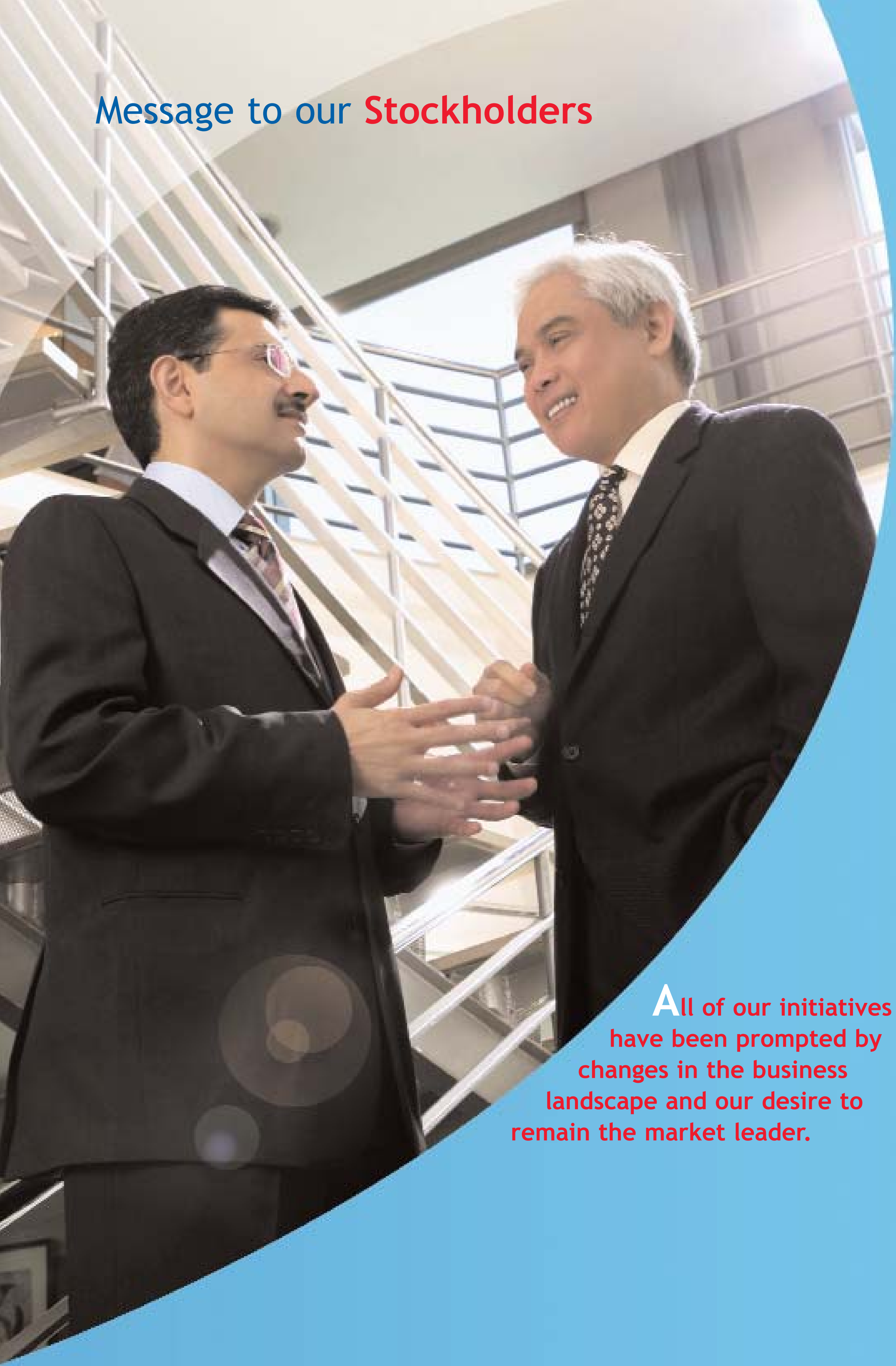
Through more than 1,200 service stations, we retail gasoline, diesel and kerosene to motorists and public transport operators. We also sell our LPG brand Gasul to households and other consumers through an extensive dealership network.

We operate a world-class lube oil blending plant at our Pandacan Terminal, where we manufacture lubes and greases. These are also sold through service stations and sales centers.

We are expanding our non-fuel businesses which include our convenience store brand "Treats." We have partnered with major fast-food chains, coffee shops, and other consumer services to give our customers a one-stop full service experience. We are also putting up additional company-owned and operated service stations in strategic locations.

We are publicly-listed. The Philippine National Oil Company and the Aramco Overseas Company B.V. each owns a 40% share of equity. The remaining 20% is held by close to 200,000 individual stockholders.

Message to our **Stockholders**



All of our initiatives have been prompted by changes in the business landscape and our desire to remain the market leader.

Despite another challenging year, your company continued to deliver more value to all of its stakeholders, including customers, employees, business partners, and of course, its shareholders.

Petron ended 2004 with earnings of ₱3.4 billion, 10% more than our 2003 net income. This growth happened amidst an environment of record crude oil prices, a deteriorating peso, and weak domestic oil demand growth. Crude prices averaged 26% higher than the previous year, and reached new highs - breaching $41.00 per barrel in August. Accordingly, the oil industry had to cope with more pressures to temper price adjustments.

The improvement in our income owes much to our drive to increase our sales volume and to take advantage of favorable export opportunities.

Our domestic sales of petroleum products grew by 14% or six million barrels higher than in 2003. As a result, we gained nearly four percentage points of market share, bringing this to 37.7% by year-end or an edge of 4.6% over our nearest competitor. With this, Petron has once again consolidated its position as the industry leader. What makes this triumph so significant is the fact that, for the first time in the history of Petron, we took the Number One position in the Retail market. We have been working to achieve this distinction amidst heavy competition, and we accomplished it a year ahead of our target.

Meanwhile, our export sales also provided strong support to our bottom line, contributing around ₱1.4 billion in terms of margins or almost double the level in 2003.

Our success in the marketplace is supported by several business initiatives that we started years ago, and continue to fine-tune in light of new developments. We remain committed to product development, diversification of markets, and customer relationship management. We continue to leverage information technology for a variety of applications including customer service, internal and external communications, supply planning and optimization, and monitoring and control of physical and financial operations. We continue to pursue best practices in organization development, risk management, environmental, health and safety programs, and corporate social responsibility.

At our Bataan refinery, we continue to pursue programs to achieve "Best in Class" status. While our competitors have elected to use regional refining capacity through imports, we remain committed to improve the reliability and efficiency of our refinery. Moreover, we have made big investments in new process units that will give us self-sufficiency in producing our domestic requirements for gasoline and diesel that comply with the stringent specifications under the Clean Air Act.

All of our initiatives have been prompted by changes in the business landscape and our desire to remain the market leader. Our performance in the last few years clearly demonstrated that your company was moving forward on a steady and sustainable growth platform. Last year, however, the management team made a conscious decision to aim for a higher growth platform and to redefine our vision and mission in line with this new thinking.

Message to our **Stockholders**

Our vision of being the most admired company of the Philippines was set in 1996 and served us well for nearly a decade. However, with the rapid changes in the business landscape we saw the need to rework our vision and mission to bring focus to our efforts and to inspire us for the next 10 to 20 years.

The new vision for Petron is "To be the leading provider of total customer solutions in the energy sector and its derivative businesses." It captures more vividly the scope of our ambitions and makes explicit our mandate to seek new business roles and to be a recognized provider of total customer solutions in the energy market and related businesses. We aim to achieve our vision by delivering a consistent customer experience, developing strategic partnerships, leveraging our refinery assets, fostering an entrepreneurial culture, and caring for our community and environment.

Our new vision/mission has a strong customer focus, but its real power rests on how well we are able to translate it into actual customer experience. The vision/mission thus requires a parallel effort to reinvigorate the Petron brand.

On this front, we have embarked on a branding program that aims to define and build on the unique character of Petron - the qualities that set us apart from our competitors and that keep customers coming back to us. We engaged an international brand consultant, and after months of research and intensive discussions, we arrived at three attributes that capture the essence of our brand promise, namely: leadership, commitment, and partnering relationships.

Leadership refers partly to the market dominance of Petron, but more importantly to the fact that we have a proven record of service innovation: from our continuing programs to improve the efficiency of our refinery and supply/distribution operations, to our pioneering of new marketing concepts - such as the expansion of service station offerings to serve more than the fuel needs of motorists, and state-of-the-art fleet management through the Petron fleet card.

Commitment is clearly manifested in our nationwide infrastructure coupled with continuing investment programs for our refining, distribution, and marketing facilities. But we also have significant social investments in the form of child education, Petron schools, and environmental programs, which show the strength of our commitment to the future of the country.

Partnering relationships have given us insights into our customers' needs, and thus enabled us to offer customized solutions that reinforce the bond we have with them. As an industry leader and joint venture partner of the world's largest oil company, we also have ties with the best organizations and suppliers around the globe.

In 2005, we will focus on bringing the Petron vision/mission and brand to life through realignment of our business strategies and organizational directions. Armed with our fresh strategic business imperatives, we are convinced that your company will reach new heights.

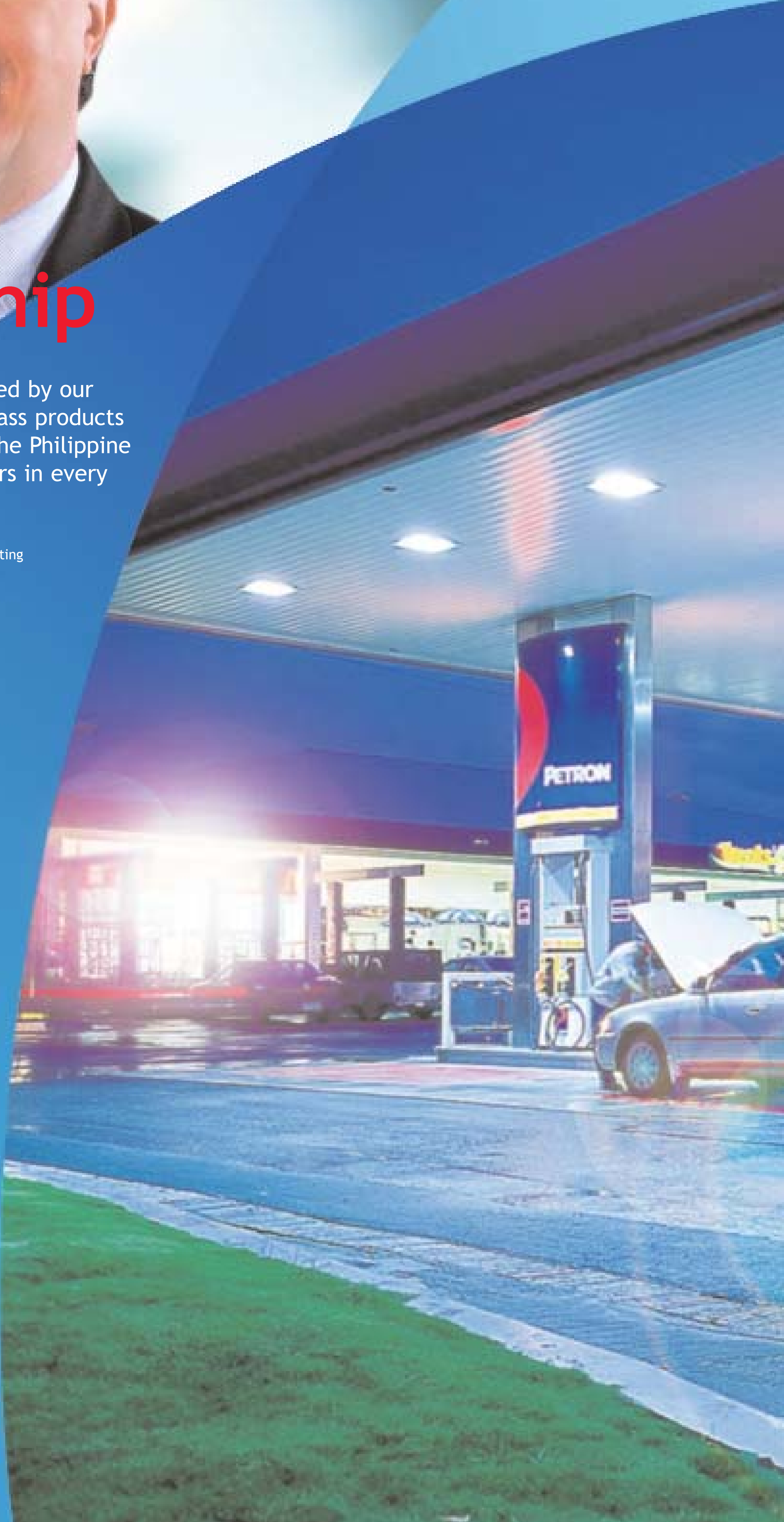
NICASIO I. ALCANTARA
Chairman

KHALID D. AL-FADDAGH
President & Chief Executive Officer

Leadership

Our leadership is fuelled by our desire to introduce world-class products and services that best suit the Philippine market. We aim to be leaders in every aspect of our business.

Jose K. Campos, Jr. Vice President for Marketing

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PETRON
Extra
Unleaded

The Year In Review

We upgraded existing facilities to enhance our services and to take customer service to a higher level.

LEADING THROUGH PARTNERSHIPS

In 2004, we continued our journey towards a brighter future for the company and its stakeholders. The story is one that reflects the attributes that Petron represents and is committed to uphold. It is a story about our brand and what it means to our customers and our other stakeholders.

LEADERSHIP

We continued to be the best performing company in the domestic oil sector as we registered a net income of ₱3.4 billion in 2004 or a 10% improvement over the previous year. This marks the fourth straight year that we have posted robust income growth.

An increase of 14% in domestic sales volumes and higher export margins, particularly for mixed xylene, contributed significantly to the bottom line. Our subsidiaries likewise brought in higher net earnings of ₱196 million, or 30% more than in 2003.

While domestic consumption of petroleum products grew by less than 2%, demand for Petron products increased by 14.4% to 47.3 million barrels. As a result, our market share increased by nearly 4 percentage points and we cornered 37.7% of the local market. Overall, our total sales volumes grew by 6% to 52.8 million barrels.

Our sales volume growth was better than industry in all the trades: Retail, Industrial, LPG, and Lubes. We now lead in all except in Lubes, and here we are slowly closing the gap with competitors.

In the Industrial Civil trade, we saw a 24.4% growth, as more and more major fuel users shifted to Petron as evidenced by our acquisition of 38 new accounts. Our share of this market is 41.8% versus 33.5% in 2003. If we count our sales to the National Power Corporation, our share of the Industrial trade is 45.3%, which is ten percentage points ahead of our nearest competitor.

In the highly competitive Retail market, which accounts for more than 40% of our local sales, we overtook our closest rival and have emerged as the service station of choice, with a market share of 33.7%. To bolster our strength in Retail and serve more Filipino motorists, we built 51 more stations and brought our service station count to 1,204 — the largest network in the country. This helped to increase our Retail volumes by 6.3%.

Service enhancements also played a role in boosting our Retail sales. Under our direct retailing program, we opened two new company-owned and operated full-service stations, complete with "Treats" convenience stores and fast-food locators. We put up three other "Treats" stores and now have 37; combined with our fast-food and service locators, these non-fuel businesses generated ₱55 million in income.

Meanwhile, from the continuing research and development activities of our Technical Services, came improved products for the motorist. We re-launched three specialty products under the Petromate brand. These are Diesel Power Booster, Oil Saver and Engine Flush. We also introduced an upgraded version of our gas engine lubricant Ultron and diesel engine lubricant Rev-X to provide additional anti-wear protection.

Our LPG brand *Gasul* continued to be the best-selling cooking gas in the market, and we maintained our lead in this market with a share of 26.5%. Looking out for our customers' convenience, we opened 64 additional branch stores during the year and launched our home delivery service in the Visayas. We likewise intensified our efforts to curb the rampant practice of selling illegally-refilled and marked LPG cylinders to protect consumer welfare.

Our successful sales performance, particularly in Retail, derived some of its momentum from our Cards business, which saw a significant increase in customer base. Users of the Petron Fleet Card — the first fleet card powered by microchip technology in the country — increased to nearly 8,000 and brought in sales of ₱129.2 million. The number of customers who enjoyed the rebates and benefits of using the Petron-BPI Mastercard nearly doubled to 18,000.

Efficient service station attendants are trained to deliver total customer experience.

The Year In Review

Equally important were our advertising and promotions efforts. The "*Walang Ganyan sa States*" campaign for our gas engine lubricant Ultron was recognized by the AdBoard of the Philippines, which awards creative works that show values related to love of family and love of country.

Underscoring the increased patronage of Petron, Superbrand International, the worldwide arbiter of brands, recently awarded us the Overall Achievement for Best Homegrown Brand. In a Superbrand survey conducted in 2004, consumers said "that when you tank up your car, you put Petron into your car and not petrol or gas...this is what true recognition is all about."

Initiatives at the Bataan refinery to produce world-class petroleum products supported our drive to produce quality fuels that meet the needs of our customers.

We continued to implement programs to improve operational availability, energy-efficiency and increased yield of higher value white products such as LPG, diesel and Mixed Xylene.

We completed our Offsites Automation Project that now makes processes such as blending, product metering, and inventory management more efficient. We modified the refinery's power distribution system to enhance reliability in preparation for the commercial operations of our two new Clean Air Act facilities.

To further bring about improvement in energy efficiency, we installed new tube exchangers in Atmospheric Pipestill (APS) 1 and 2 as part of its heat recovery program. This is expected to save more than 6 megawatts on an annual basis. Our Powerformer and Naphtha Hydrotreater decoupling project maximizes naphtha upgrading and eliminates energy wastage. It has already been completed and 21.5 megawatts is expected to be saved yearly.

At the heart of all these projects is an on-going organizational transformation scheme known as STEP or Survival Thru Excellence Program that promotes a culture of continuous improvement and effectiveness.

All these initiatives are aimed at making our Bataan refinery "Best-in-Class" by 2005. Once achieved, this would enable it to match or even surpass the operational efficiencies of similar facilities in the region.

Meanwhile, we also continued to improve our distribution system to reduce transshipment costs while ensuring timely deliveries to our customers. We employed the Global Positioning System (GPS) technology to monitor our tank truck deliveries. This allows our dispatchers to effectively plan trips and assignments of customer orders. We also adopted new security seals for our haulers' trucks and barges to assure customers that the Petron products delivered to them are of the right quality and quantity.

Leadership and teamwork among employees are being enhanced further through new training programs that give them the expertise to make decisions on strategic business imperatives.

A new aviation storage and into-plane facility at our Davao Airport Depot was built, while we increased our LPG storage capacity at our Palawan Depot. These two facilities enhance our ability to reliably supply the needed products in these areas.

To further enhance our leadership and support our new Vision and Mission, we continued to introduce new training programs. Process owners from various departments conducted "Petron 101" geared to provide employees with a better understanding of our corporate objectives. Our "Partnerships for Success" program gave our employees the opportunity to make decisions on resource planning and allocation, financial management, and other business imperatives.

COMMITMENT

Our commitment to our stakeholders is based on a long-term view of our role in the economy. Through all the years of our existence, we have aimed for sustainability of the business based on a regard for emerging needs of the market.

A good instance of this commitment was our decision to invest $100 million

We always come up with ways to delight our customers.

Safety inspection is regularly done at our world-class lubeoil blending plant in Pandacan.

Commitment

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Basil A. Abul-Hamayel
Vice President for Corporate Planning

The Year In Review

to build new refinery facilities — an Isomerization Unit (Isom) and a Gasoil Hydrotreater (GOHT) — that will make us the only oil company in the Philippines capable of locally producing Clean Air Act-compliant fuels to supply our market. The Isom will produce gasoline within the prescribed aromatics and benzene limits (35% and 2%, respectively) while the GOHT will turn out low-sulfur diesel.

The two units — to be fully operational by early 2005 — will not only produce environment-friendly fuels but will also lessen the country's dependence on imported products.

We have also intensified our efforts at our refinery to exceed the environmental standards and regulations set by the government. For our environmental programs and facilities, we were given the prestigious ISO-14001 Environmental Management Systems certification after only one round of environmental audits by TUV Suddeutschland (SUD) Group.

Outside of the refinery, our initiatives in the area of Health, Safety and Environment (HSE) bore fruit last year as we logged impressive safety records at major facilities. Our Pandacan Terminal registered two million man-hours without lost time injury (LTI) while our Mandaue and Rosario terminals posted 500,000 man-hours each without LTI.

In twelve of our port locations, including the refinery and Pandacan Terminal, we received the International Ship Port Security (ISPS) certificates from the Department of Transportation and Communications (DOTC).

Our total efforts in HSE resulted in lower insurance premiums for 2005 for our facilities. For the refinery alone, we were able to save ₱58 million in insurance premiums.

Our commitment to our business is inextricably entwined with our commitment to the future of the nation, thus we feel bound to take an active role in the preservation of the environment and the promotion of literacy and education among the country's youth.

Our ArtPetron contest continued to create an affinity with the youth and provide them a creative medium of expression. On its fourth year, ArtPetron with the theme "Lumang Ani, Bagong Sali" (Old Harvests, New Interpretation) drew more than 400 students from several universities across the country.

Through our Petron Foundation, and in cooperation with the Department of Education

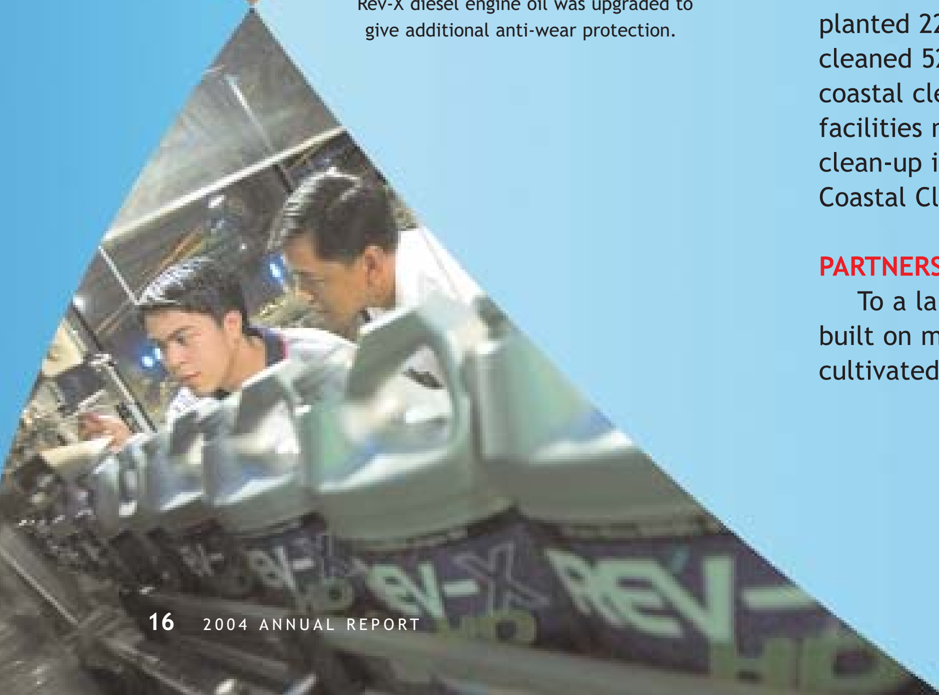
We also continued to improve our distribution system to reduce transshipment while ensuring timely deliveries to our customers.

and the Department of Social Welfare and Development, we gave educational assistance to more than 2,000 underprivileged children last year under our flagship educational program *"Tulong Aral ng Petron."* These children are enrolled in 80 public elementary schools in 12 cities and municipalities in Metro Manila. To supplement this program, we also involved the parents of our scholars by organizing workshops for parent effectiveness and livelihood opportunities.

Parallel to our cause of helping to create a brighter future for underprivileged children, we built three new schools in 2004 in areas where educational facilities were sorely lacking. To date, we have built six three-classroom buildings — five in Mindanao and

The Year In Review

Regular fire drills are among the safety programs being conducted in all depots and terminals.



Rev-X diesel engine oil was upgraded to give additional anti-wear protection.

one in Bataan through our "Petron School Program." We have also secured assistance from the US Agency for International Development to undertake a three-year initiative to build a total of 17 Petron Schools in Mindanao.

To share the experience and insights we drew from our educational programs, we published a case book entitled "Tulong Aral ng Petron: A Corporation's Response to Fight Poverty." We produced this book to serve as a detailed guide for individuals and organizations wishing to implement their own educational programs.

With regard to the environment, we sustained our drive for cleaner shores through our "*Kontra-Kalat sa Dagat*" coastal management program. We planted 22,000 mangrove propagules in Bataan and cleaned 52 kilometers of its coastline. Several coastal clean-up activities were done near our facilities nationwide, including a Manila Bay-wide clean-up in celebration of the 18th International Coastal Clean-up Day.

PARTNERSHIPS

To a large degree, our success as a company is built on meaningful relationships that we have cultivated over the years. Successful collaborations

with other entities have helped pushed the company's programs forward. We can cite many instances.

In 2004, our partnership with Saudi Aramco continued to assure us of a reliable and uninterrupted supply of crude oil in an environment of tighter global supplies and uncertainty over prices. This alliance, by providing us with the right crude types, has also helped us continue to serve niche markets for products that we export to the Asian region.

Likewise, strategic partnerships with regional business entities have given us a wider customer base in the international market. We sold 5.5 million barrels of various petroleum products (LPG, gasolines, naphtha, reformate, mixed xylene and SRFO) to other Asian countries such as Korea, Singapore, Australia, and China. These were on the basis of supply agreements that gave us favorable terms.

We likewise tapped the services of leading global service companies to improve our local operations. We partnered with Microsoft, the world's leading provider of software, to roll out our Point-of-Sale (POS) system in eight service stations during the year. The POS system automates many sales and inventory-related processes at the station level, and enables more systematic market sales analysis. More importantly, the automation of these procedures helps provide our customers with more efficient and consistent service. We will be deploying our POS system in more service stations in 2005.

To increase our responsiveness to market demand and further optimize our supply chain, we worked with i2 Technologies, Inc., a leading provider of supply chain management solutions, to develop and deploy a software that will address this. The Demand Planner will help us improve our product sales forecasts and allow the purchase of the optimal crude mix as well as ensure product availability to serve the customers. On the other hand, the Distribution Optimizer will help Petron lower its freight costs by generating a feasible daily shipment schedule for all depots at the least cost.

At our refinery, we have an ongoing Supplier Alliance Program with several contractors which guarantee the availability of material supply at the lowest cost.

Internationally-recognized institutions, namely the World Safety Organization, Resource Protection International, and Quest, Inc. helped us provide the necessary knowledge to boost HSE awareness among our employees and our business partners. We also recognize our partnership with DuPont Safety Resources Services which was instrumental in raising the bar of safety practices across the organization.

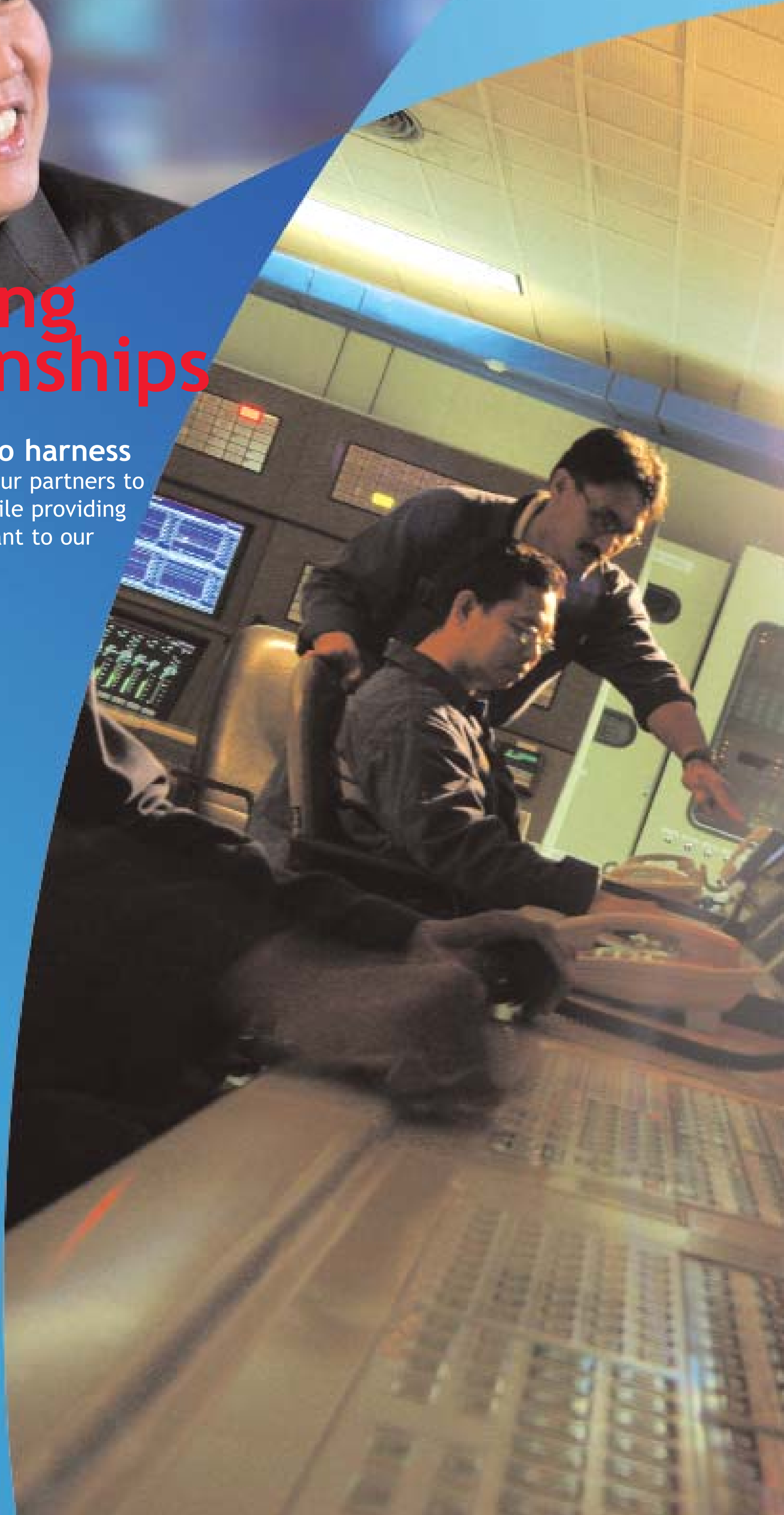
In cooperation with other industry players, we established a joint venture company, the Pandacan Depot Services Inc. (PDSI), to manage and operate our scaled-down Pandacan Terminal. We expect that the integration will result in improved operating efficiencies and lower our costs. This joint project establishes a benchmark of collaboration in the oil sector.

We worked closely with the Department of Energy (DOE), DOTC and various transport groups as we implemented our nationwide diesel discount

Partnering Relationships

We have been able to harness the combined expertise of our partners to make the company grow while providing products and services relevant to our customers.

Alfred A. Trio Vice President for Refining



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More and more underprivileged children are now benefiting from "Tulong Aral ng Petron".

program for public transport operators. This program, aimed at cushioning the impact of the continuous rise in international fuel prices for the riding public, has been instrumental in boosting our sales of automotive diesel. More than 70 of our service stations gave the discount in 2004 and we brought the number to 100 in early 2005.

We also have a partnership with the Asian Institute of Management for providing our employees with intensive and expert training on strategic thinking, leadership, and effective decision-making.

Partnerships have helped us obtain cost-efficient means for financing our investments. Through the long-term relationships we have with Citibank/Citigroup Global Markets Asia, ING Bank N.V. and SAMBA Financial Group, we were able to obtain a $100 million term loan whose pricing established a new benchmark in the Philippine market.

Partnerships also play a crucial role in developing future product lines for the company. Recognizing the growing attractiveness of alternative fuels in a more environment-conscious market, we are developing two new types of fuel for motorists. One is AutoLPG, which we are now providing to certain transport companies on a pilot basis. We are being supported in this by the

Our corporate social responsibility projects depend heavily on partnering arrangements with other business groups.

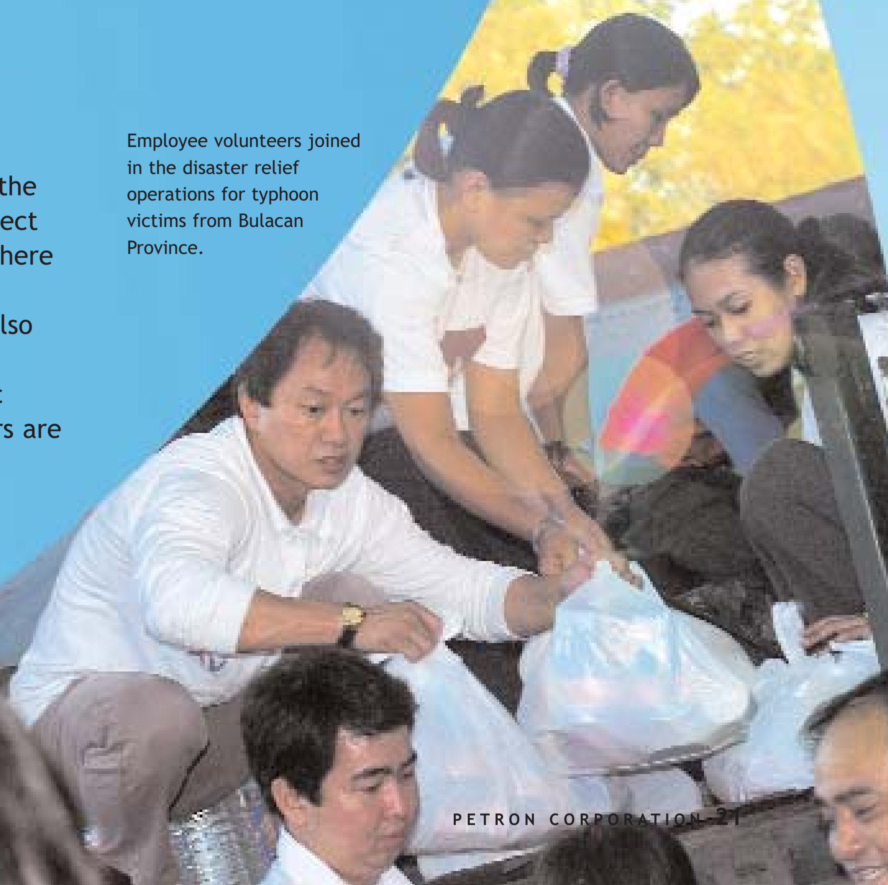
Development Bank of the Philippines, whose vehicle fleet at their head office has already been converted to take the fuel, and who has a program to finance conversion kits for transport cooperatives. We currently have four stations dispensing AutoLPG and we are planning to build more as demand increases. We refitted 74 taxi units with AutoLPG conversion kits during the year.

The other alternative fuel is ethanol, which is not only environment-friendly, but can also support a new agri-industry to help our farm sector. Through a partnership with the Philippine Ethanol Alliance composed of sugar millers, producers, and distillers, the Sugar Regulatory Administration and DOE, we have been actively involved in setting up the institutional and legal framework to make the fuel a viable alternative for motorists.

We continued to support various organizations in line with our efforts to promote grassroots sports development. One is our long-time partnership with the Philippine Taekwondo Association wherein we sponsor our national team to international tournaments and help them achieve their dream of bringing glory to the country.

Last but not least, our corporate social responsibility projects depend heavily on partnering arrangements with other business groups. For example, we got the support of the Ronald McDonald House Charities for our Project JOY, an annual event in Malacañang Palace where we share the gifts of Christmas with underprivileged children. The collaboration also allows us to adopt their "Bright Minds Read" program, which encourages children in public elementary schools where Tulong Aral scholars are enrolled, to read books. Mirant Philippines Foundation has also pledged to replicate our Tulong Aral program for beneficiaries in the Visayas region.

When Petron volunteered to help in disaster relief operations following the series of typhoons that hit the country in late 2004, we coordinated with the Petron Dealers Association, DOE and ABS-CBN to be able to deliver relief goods to affected provinces. More than 150 of our service stations were utilized as drop-off points for relief goods. We also coordinated the efforts of the League of Corporate Foundations and the Corporate Network for Disaster Response to help victims in the provinces of Quezon, Camarines Sur, Bulacan, Nueva Ecija and Isabela. More than 10,000 families were able to draw some comfort from these efforts.



Employee volunteers joined in the disaster relief operations for typhoon victims from Bulacan Province.

Partnerhips

Partnerships have helped us
obtain cost-efficient means for financing our investments.

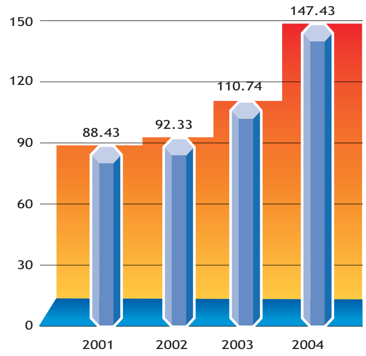
Antonio G. Pelayo Vice President for Finance and Subsidiaries


PETRON
PETRON

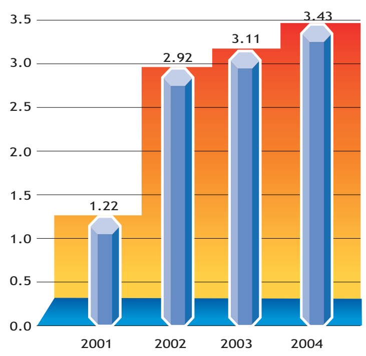
Financial Highlights

(In Million Pesos)	2004	2003	2002	2001
SALES	147,425	110,737	92,330	88,427
NET INCOME (LOSS)	3,425	3,114	2,921	1,224
OPERATING EXPENSES	4,883	3,837	3,512	3,704
INCOME (LOSS) FROM OPERATIONS	5,865	5,547	5,350	3,499
PLANT, PROPERTY & EQUIPMENT	24,862	21,497	21,531	22,703
TOTAL ASSETS	61,417	51,201	50,576	50,868
TOTAL EQUITY	21,224	19,670	18,821	17,303
(In Pesos Per Share)				
EARNINGS PER SHARE	0.37	0.33	0.31	0.13
CASH DIVIDEND DECLARED	0.20	0.20	0.15	-

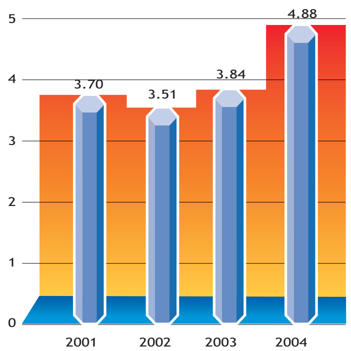
Sales Revenue
(In Billion Pesos)



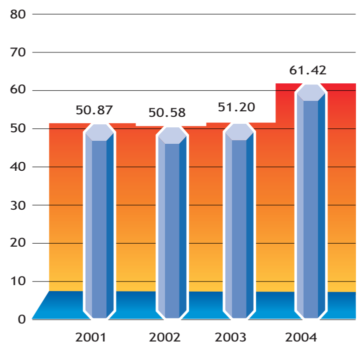
Net Income
(In Billion Pesos)



Operating Expenses
(In Billion Pesos)



Total Assets
(In Billion Pesos)



IMPROVING PROFIT GROWTH

In 2004, Petron Corporation posted a net income of ₱3.43 billion or an earnings per share of 37 centavos. This was 10% higher year-on-year and surpassed the 7% profit growth rate achieved in 2003 relative to 2002.

Earnings growth was driven by gross profit expansion and the containment of non-operating charges but tempered by higher operating expenses.

The company paid out dividends of ₱1.88 billion or 20 centavos per share during the year. It ended 2004 with a book value of ₱21.22 billion or ₱2.26 per share, 8% better than the end-2003 book value of ₱19.67 billion or ₱2.10 per share.

6% SALES VOLUME EXPANSION

Total sales volume increased 6% to 52.76 million barrels during the year.

Volume expansion was boosted by domestic sales which grew by 14% during the year. This, in turn, was driven primarily by a 24% surge in industrial sales, coupled with a 7% improvement in the retail segment.

Petron's sales growth can be attributed mainly to market share expansion since Philippine oil demand was estimated to have grown by only 2% in 2004.

Meanwhile, soaring oil prices and the necessity to maintain financial viability have resulted to a 27% increase in average selling prices. Consequently, Petron's net sales revenue surged 33% to ₱147.43 billion from ₱110.74 billion in 2003.

RESULTING TO A 15% GROSS PROFIT IMPROVEMENT

On the back of the 6% sales volume improvement, Petron's 2004 gross profit grew 15% to ₱10.75 billion from ₱9.38 billion in the prior year. However, gross profit relative to sales revenue contracted to 7.3% in 2004 from 8.5% in 2003 as the 35% increase in cost of goods sold outpaced the 33% revenue improvement.

The higher cost of goods sold can be attributed to a 28% increase in the FOB price of crude oil that went into production, a 64% increase in freight costs and a 3% deterioration in the value of the peso against the dollar during the year. All these resulted to a 36% surge in direct material costs which constituted 98% of the cost of goods sold in 2004.

PARTLY OFFSET BY A 27% INCREASE IN OPERATING EXPENSES

Meanwhile, 2004 operating expenses grew 27% to P4.88 billion, attributable to incremental costs for materials and supplies, particularly Gasul cylinders, and for business activities. Moreover, there were expense bookings related to the migration to International Accounting Standards and an additional doubtful account provision to match the increase in gross receivables.

Nevertheless, operating expenses for 2001 to 2004 increased by only 10% yearly on the average.

FLAT NON-OPERATING CHARGES AND INCOME TAX

On the other hand, various treasury and risk management initiatives undertaken by the company effectively contained 2004 net non-operating expense to ₱1.426 billion, ₱2 million less than in 2003. This was achieved despite a 44% increase in net interest-bearing liabilities to ₱23.13 billion at end-2004 from ₱16.12 billion at the start of the year.

Petron's income tax provision of ₱1.01 billion was likewise flat year-on-year. The 2004 tax provision amounted to 23% of pre-tax income and its difference from the statutory 32% corporate income tax rate can be traced to the income tax holiday granted to Petron's mixed xylene operations. Mixed xylene comprised 29% of the company's 2004 pre-tax income of ₱4.44 billion, up from 22% in the prior year.

The income tax holiday for mixed xylene will lapse in December 2005.

₱242 MILLION CASH GENERATED FROM OPERATIONS

Cash generated by operating activities amounted to ₱242 million in 2004. Petron's income adjusted for non-cash accounts reached ₱5.52 billion during the year but ₱5.28 billion of this had to be used to fund incremental working capital. Funding for working capital surged during the year due to higher oil prices which increased the cost of inventory purchased and the amount of sales booked on credit, and despite turnover ratios that were mainly unchanged year-on-year.

HIGHER CAPITAL SPENDING

Capital spending surged to ₱5.47 billion in 2004 from ₱1.65 billion in 2003 on account of the isomerization and gasoil hydrotreater projects at the Bataan Refinery. These two investments would allow the production of Clean Air Act-compliant gasoline and diesel products and should be operational by the middle of 2005. Prior to these projects, Petron resorted to the use of imported components blended with its refined products to comply with the Clean Air Act.

Funding for these projects, as well as for 2004's ₱1.85 billion cash dividend payment, came mainly from bank loans. Debt availment net of repayments reached ₱7.91 billion during the year, compared to a ₱2.04 billion net repayment of debt in 2003.

₱10 BILLION INCREASE IN ASSETS

Petron's asset base climbed to ₱61.42 billion at end-2004, significantly higher by ₱10.22 billion from the end-2003 level.

Aside from higher fixed assets as a result of the isomerization and gasoil hydrotreater projects, Petron's asset base increased on account of higher inventory and receivable levels, which grew by ₱3.56 billion and ₱2.34 billion, respectively.

Asset growth was funded by a ₱8.66 billion increase in debt and other liabilities and ₱1.55 billion of earnings reinvested during the year. Consequently, Petron's leverage increased during the year, with its debt-to-total assets ratio reaching 65% at end-2004 from 62% at the start of the year. However, the company's liquidity improved with the current ratio at 1.14 at end-2004 from 1.10 at the start of the year.

Meanwhile, Petron's return on equity marginally improved to 17% from 16% in the prior year.

EFFECTS OF IAS ADOPTION

The company already adopted in its 2004 financial report the IAS for income taxes (IAS 12) and leases (IAS 17), as required by the Securities and Exchange Commission.

These accounting changes resulted to minor adjustments in Petron's 2003 consolidated financial statements, namely: (1) a ₱402 million downward restatement of stockholders' equity, 2% lower than the originally reported balance; and (2) a ₱6 million increase in net income, which translated to a 0.2% raise in the previously reported 2003 net income of ₱3.108 billion. Accordingly, cash flows in 2003 and 2002 were restated to reflect the accounting changes made.

Petron expects to fully conform to IAS by 2005. The relevant accounting standards planned for adoption by the company are enumerated in the Notes to Consolidated Financial Statements.

Statement of Management's Responsibility for Financial Statements

The management of Petron Corporation is responsible for all information and representations contained in the consolidated balance sheets as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity and cash flows for the years ended December 31, 2004, 2003 and 2002. The financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

In this regard, management maintains a system of accounting and reporting which provides for the necessary internal controls to ensure that transactions are properly authorized and recorded, assets are safeguarded against unauthorized use or disposition and liabilities are recognized. The management likewise discloses to the company's audit committee and to its external auditor: (i) all significant deficiencies in the design or operation of internal controls that could adversely affect its ability to record, process, and report financial data; (ii) material weaknesses in the internal controls, and (iii) any fraud that involves management or other employees who exercise significant roles in internal controls.

The Board of Directors reviews the financial statements before such statements are approved and submitted to the stockholders of the Company.

SyCip Gorres Velayo & Co., the independent auditors appointed by the stockholders, have examined the financial statements of the Company in accordance with generally accepted auditing standards in the Philippines and have expressed their opinion on the fairness of presentation upon completion of such examination, in their report to the Board of Directors and stockholders.

MA. CONCEPCION F. DE CLARO
Controller

NICASIO I. ALCANTARA
Chairman

Report of Independent Public Accountants

SGV & Co

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The Stockholders and the Board of Directors
Petron Corporation
Petron MegaPlaza
358 Sen. Gil Puyat Avenue
Makati City

We have audited the accompanying consolidated balance sheets of Petron Corporation and Subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the Philippines. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Petron Corporation and Subsidiaries as of December 31, 2004 and 2003, and the results of its operations and their cash flows for each of the three years in the period ended December 31, 2004 in conformity with the accounting principles generally accepted in the Philippines.

SyCip Gorres Velayo & Co.

Wilson P. Tan
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-A
Tax Identification No. 102-098-469
PTR No. 9404036, January 3, 2005, Makati City

March 1, 2005

Consolidated Balance Sheets

(Amounts in Millions)

	December 31 2004	2003 (As restated- Note 2)
ASSETS		
Current Assets		
Cash and cash equivalents (Note 3)	**₱4,104**	₱3,198
Short-term investments - net (Note 4)	**63**	69
Receivables - net (Note 5)	**11,828**	9,491
Inventories - net (Notes 6, 20 and 23)	**19,235**	15,674
Other current assets	**720**	730
Total Current Assets	**35,950**	29,162
Noncurrent Assets		
Investments - net (Notes 7 and 8)	**417**	462
Property, plant and equipment - net (Note 9)	**24,862**	21,497
Other noncurrent assets (Note 10)	**188**	80
Total Noncurrent Assets	**25,467**	22,039
	₱61,417	₱51,201
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Short-term loans (Note 11)	**₱18,477**	₱15,385
Liabilities for crude oil and petroleum product importation (Note 20)	**6,128**	6,560
Accounts payable and accrued expenses (Note 12)	**5,191**	3,965
Income tax payable	**278**	14
Current portion of long-term debt (Note 13)	**1,615**	712
Total Current Liabilities	**31,689**	26,636
Noncurrent Liabilities		
Long-term debt - net of current portion (Note 13)	**7,207**	3,288
Deferred income tax liabilities - net (Note 16)	**882**	1,207
Other noncurrent liabilities (Note 14)	**415**	400
Total Noncurrent Liabilities	**8,504**	4,895
Stockholders' Equity (Note 15)		
Capital stock	**9,375**	9,375
Retained earnings:		
Appropriated	**6,906**	5,551
Unappropriated	**4,858**	4,663
Accumulated translation adjustments (Note 16)	**85**	81
Total Stockholders' Equity	**21,224**	19,670
	₱61,417	₱51,201

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Income

(Amounts in Millions, Except Per Share Amounts)

	Years Ended December 31		
	2004	2003 (As restated-Note 2)	2002 (As restated-Note 2)
SALES (Notes 23 and 28)	**₱147,425**	₱110,737	₱92,330
COST OF GOODS SOLD (Notes 6, 17, 20, 23, 26 and 27)	**136,677**	101,353	83,468
GROSS PROFIT	**10,748**	9,384	8,862
OPERATING EXPENSES (Notes 18 and 20)	**4,883**	3,837	3,512
INCOME FROM OPERATIONS	**5,865**	5,547	5,350
OTHER CHARGES - Net			
Interest (Notes 11, 13 and 19)	**(1,095)**	(1,258)	(811)
Reversal of allowance (provision) for decline			
in value of investments (Notes 4, 7 and 16)	**(91)**	12	5
Foreign exchange loss (Note 26)	**(22)**	(16)	(200)
Bank charges and others	**(218)**	(166)	(189)
	(1,426)	(1,428)	(1,195)
INCOME BEFORE INCOME TAX	**4,439**	4,119	4,155
PROVISION FOR (BENEFIT FROM)			
INCOME TAX (Notes 16 and 27)			
Current	**1,339**	782	261
Deferred	**(325)**	223	973
	1,014	1,005	1,234
NET INCOME	**₱3,425**	₱3,114	₱2,921
EARNINGS PER SHARE (Note 24)	**₱0.37**	₱0.33	₱0.31

See accompanying Notes to Consolidated Financial Statements.

Consolidated Statements of Changes in Stockholders' Equity

For each of the three years in the period ended December 31, 2004
(Amounts in Millions, Except Per Share Amounts)

	Capital Stock (Note 15)	Retained Earnings (Notes 2 and 15) Appropriated	Unappropriated	Accumulated Translation Adjustment (Notes 2 and 16)	Total
Balance at December 31, 2001, as previously reported	₱9,375	₱4,612	₱3,225	₱91	₱17,303
Effect of change in accounting for:					
Leases	-	-	(377)	-	(377)
Income Taxes	-	-	-	(29)	(29)
Balance at December 31, 2001, as restated	9,375	4,612	2,848	62	16,897
Net income for the year	-	-	2,921	-	2,921
Appropriated for capital projects	-	939	(939)	-	-
Cash dividends - ₱0.15 per share	-	-	(1,406)	-	(1,406)
Foreign currency translation adjustments - net of deferred income tax	-	-	-	7	7
Balance at December 31, 2002, as restated	₱9,375	₱5,551	₱3,424	₱69	₱18,419
Balance at December 31, 2002, as previously reported	₱9,375	₱5,551	₱3,794	₱101	₱18,821
Effect of change in accounting for:					
Leases	-	-	(370)	-	(370)
Income Taxes	-	-	-	(32)	(32)
Balance at December 31, 2002, as restated	9,375	5,551	3,424	69	18,419
Net income for the year	-	-	3,114	-	3,114
Cash dividends - ₱0.20 per share	-	-	(1,875)	-	(1,875)
Foreign currency translation adjustments - net of deferred income tax	-	-	-	12	12
Balance at December 31, 2003, as restated	₱9,375	₱5,551	₱4,663	₱81	₱19,670
Balance at December 31, 2003, as previously reported	₱9,375	₱5,551	₱5,027	₱119	₱20,072
Effect of change in accounting for:					
Leases	-	-	(364)	-	(364)
Income Taxes	-	-	-	(38)	(38)
Balance at December 31, 2003, as restated	9,375	5,551	4,663	81	19,670
Net income for the year	-	-	3,425	-	3,425
Appropriated for capital projects	-	1,355	(1,355)	-	-
Cash dividends - ₱0.20 per share	-	-	(1,875)	-	(1,875)
Foreign currency translation adjustments - net of deferred income tax	-	-	-	4	4
Balance at December 31, 2004	**₱9,375**	**₱6,906**	**₱4,858**	**₱85**	**₱21,224**

See accompanying Notes to Consolidated Financial Statements.

Consolidated

Statements of Cash Flows

(Amounts in Millions)

	Years Ended December 31		
	2004	2003	2002
		(As restated-Note 2)	
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱4,439**	₱4,119	₱4,155
Adjustments for:			
Depreciation and amortization	**2,104**	2,114	2,284
Interest expense	**1,439**	1,493	1,068
Interest income	**(344)**	(235)	(257)
Provision (reversal of allowance) for decline in value of investments	**91**	(12)	(5)
Cylinder deposits written-on	**(69)**	(224)	–
Unrealized foreign exchange loss - net	**48**	33	184
Reversal of allowance for doubtful accounts and others	**(17)**	–	–
Operating income before working capital changes	**7,691**	7,288	7,429
Changes in operating assets and liabilities (Note 25)	**(5,282)**	(2,784)	(120)
Interest paid	**(1,435)**	(1,484)	(1,084)
Income taxes paid	**(1,075)**	(353)	(284)
Interest received	**343**	244	254
Net cash provided by operating activities	**242**	2,911	6,195
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	**(5,469)**	(1,646)	(1,106)
Decrease (increase) in:			
Other receivables	**160**	515	51
Other noncurrent assets	**(114)**	(43)	29
Reductions from (additions to):			
Investments	**(53)**	28	300
Short-term investments	**19**	–	–
Acquisition of a subsidiary, net of cash acquired (Note 25)	**–**	(209)	–
Net cash used in investing activities	**(5,457)**	(1,355)	(726)
CASH FLOWS FROM FINANCING ACTIVITIES			
Availments of loans	**80,854**	27,447	36,647
Payments of:			
Loans	**(72,949)**	(29,491)	(39,855)
Cash dividends	**(1,846)**	(1,829)	(1,380)
Cylinder deposits received and others	**90**	128	109
Net cash provided by (used in) financing activities	**6,149**	(3,745)	(4,479)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(28)**	(32)	(10)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**906**	(2,221)	980
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**3,198**	5,419	4,439
CASH AND CASH EQUIVALENTS AT END OF YEAR	**₱4,104**	₱3,198	₱5,419

See accompanying Notes to Consolidated Financial Statements.

1. Corporate Information

Petron Corporation (Petron) was incorporated on December 15, 1966 under the laws of the Republic of the Philippines. Petron is the Philippines' largest oil refining and marketing company, supplying more than one-third of the country's oil requirements. Its refinery located in Limay, Bataan processes crude oil into a full range of petroleum products, including liquefied petroleum gas (LPG), gasoline, diesel, jet fuel, kerosene, industrial fuel oil, lubes and greases, and asphalts. From the refinery, Petron moves its products mainly by sea, using tankers and barges to distribute products to a nationwide network of bulk plants and terminals. Through this network, it sells fuel oil, diesel and LPG to industrial customers.

Petron retails gasoline, diesel and kerosene to motorists, public transport operators and households through more than a thousand service stations and sells its LPG brand to consumers through a dealership network.

The principal activities of the subsidiaries are described in Note 2 under "Basis of Consolidation and Investments."

The registered office address of Petron and its Philippine-based subsidiaries is Petron MegaPlaza, 358 Sen. Gil Puyat Avenue, Makati City. The number of employees of Petron and subsidiaries was 1,234 as of December 31, 2004 and 1,212 as of December 31, 2003.

The consolidated financial statements as of December 31, 2004 and 2003 and for each of the three years in the period ended December 31, 2004 were authorized for issue by the Board of Directors on March 1, 2005.

2. Summary of Significant Accounting Policies

Basis of Preparation

The accompanying consolidated financial statements of Petron (the ultimate parent company) and subsidiaries (collectively referred to as "the Company") have been prepared in conformity with the accounting principles generally accepted in the Philippines under the historical cost convention.

Use of Estimates

The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The estimates and assumptions used in the accompanying consolidated financial statements are based upon management's evaluation of relevant facts and circumstances as of the date of the consolidated financial statements. Actual results could differ from such estimates.

Adoption of New Statements of Financial Accounting Standards (SFAS)/International Accounting Standards (IAS)

The Company adopted the following new SFAS/IAS, which became effective for financial statements covering periods beginning on or after January 1, 2004:

- SFAS 12/IAS 12, "Income Taxes," prescribes the accounting treatment for current and deferred income taxes. The standard requires the use of the balance sheet liability method in accounting for deferred income taxes. It requires the recognition of a deferred tax liability and, subject to certain conditions, deferred tax asset for all temporary differences with certain exceptions. The standard provides for the recognition of a deferred tax asset when it is probable that taxable income will be available against which the deferred tax asset can be used. The changes in policy were reflected in the consolidated financial statements on a retroactive basis. Adoption of this standard reduced stockholders' equity by ₱38, ₱32 and ₱29 as of January 1, 2004, 2003, 2002, respectively, representing the deferred income tax impact on accumulated translation adjustments pertaining to Overseas Ventures Insurance Corporation Ltd. (Ovincor, a 100%-owned subsidiary incorporated under the laws of Bermuda).

- SFAS 17/IAS 17, "Leases," prescribes the accounting policies and disclosures to apply to finance and operating leases. Adoption of the standard resulted in the recognition of lease payments and receipts under operating leases on a straight-line basis. Previously, all lease payments and receipts under operating leases were expensed or recognized as rental income based on the terms of the lease agreements. The change in policy is reflected in the consolidated financial statements on a retroactive basis. Net income increased by ₱6 and ₱7 in 2003 and 2002, respectively. Retained earnings decreased by ₱364, ₱370, and ₱377 as of January 1, 2004, 2003 and 2002, respectively.

New Accounting Standards Effective in 2005

New accounting standards based on IAS and International Financial Reporting Standards, referred to as Philippine Accounting Standards (PAS) or Philippine Financial Reporting Standards (PFRS), will become effective in 2005. The Company and a joint venture will adopt the following new accounting standards that are relevant to them effective January 1, 2005.

- PAS 19, "Employee Benefits," will result in the use of the projected unit credit method in measuring retirement benefit expense and a change in the manner of computing benefit expense relating to past service cost and actuarial gains and losses. It requires a company to determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the balance sheet date. Upon adoption of the standard, the transition pension asset under the Company's defined benefit plan will be adjusted retroactively and will increase retained earnings and noncurrent assets by ₱855 as of January 1, 2005 (see Note 22).

- PAS 21, "The Effects of Changes in Foreign Exchange Rates," will result in the elimination of the capitalization of foreign exchange losses. As of December 31, 2004 and 2003, undepreciated capitalized foreign exchange losses included in property, plant and equipment amounted to ₱2,182 and ₱2,411(see Note 9). Upon adoption of PAS 21, any undepreciated capitalized foreign exchange losses will be adjusted against beginning retained earnings and prior years' consolidated financial statements presented will be restated. The effect will be a reduction in retained earnings of ₱1,612, ₱1,784 and ₱2,128 (net of income tax effects) as of January 1, 2005, 2004 and 2003, respectively, and reduction of property, plant and equipment by ₱2,182 and ₱2,411 as of December 31, 2004 and 2003, respectively.

- PAS 32, "Financial Instruments: Disclosure and Presentation," covers the disclosure and presentation of all financial instruments. The standard requires more comprehensive disclosures about a company's financial instruments, whether recognized or unrecognized in the financial statements. New disclosure requirements include the terms and conditions of financial instruments, types of risks associated with both recognized and unrecognized financial instruments (market risk, price risk, credit risk, liquidity risk and cash flow risk), fair value information of both recognized and unrecognized financial assets and financial liabilities and the company's financial risk management policies and objectives. The standard also requires financial instruments to be classified as liabilities or equity in accordance with its substance and not its legal form. Adoption of this standard is not expected to have a significant impact to the Company. New disclosures required by this standard, will be included in the 2005 consolidated financial statements, as applicable.

- PAS 39, "Financial Instruments: Recognition and Measurement," establishes the accounting and reporting standards for the recognition and measurement of the company's financial assets and financial liabilities. The standard requires a financial asset or financial liability to be recognized initially at fair value. Subsequent to initial recognition, the company should continue to measure financial assets at their fair values, except for loans and receivables and held-to-maturity investments, which are to be measured at cost or amortized cost using the effective interest rate method. Financial liabilities are subsequently measured at cost or amortized cost, except for liabilities classified as "at fair value through profit and loss" and derivatives, which are subsequently to be measured at fair value.

  PAS 39 also covers the accounting for derivative instruments. This standard has expanded the definition of a derivative instrument to include derivatives (and derivative-like provisions) embedded in non-derivative contracts. Under the standard, every derivative instrument is recorded in the balance sheet as either an asset or liability measured at its fair value. Derivatives that do not qualify as hedges are adjusted to fair value through income. If a derivative is designated and qualify as a hedge, depending on the nature of the hedging relationship, changes in the fair value of the derivative are either offset against the changes in fair value of the hedged assets, liabilities and firm commitments through earnings or recognized in stockholders' equity until the hedged item is recognized in earnings. A company must formally document, designate and assess the hedge effectiveness of derivative transactions that receive hedge accounting treatment.

  Adoption of PAS 39 is expected to have operational and financial statement impact to the Company which is not presently quantifiable. Volatility in the financial statements is anticipated because of the requirement to fair value most financial instruments, including derivative financial instruments. The Company plans to undertake certain detailed activities, which include, among others, the following:

  1. Review of contracts for the purpose of identifying and, where required, bifurcating derivatives that are embedded in both financial and non-financial contracts;

  2. Development of a financial instruments policy that will cover accounting for financial instruments, to include the preparation of hedge accounting guidelines and requirements for derivatives that are designated and qualify as hedges;

  3. Evaluation on the proper classification of financial instruments, including determining whether a financial instrument should be accounted for as debt or equity; and,

  4. Assessment of required process and systems changes.

  In 2005, the impact of adopting PAS 39 will be retroactively computed, as applicable, and adjusted to January 1, 2005 retained earnings. Prior years' consolidated financial statements, as allowed by the Securities and Exchange Commission, will not be restated.

- PAS 40, "Investment Property," prescribes the accounting treatment for investment property and related disclosure requirements. This standard permits a company to choose either the fair value model or cost model in accounting for investment property. Fair value model requires an investment property to be measured at fair value with fair value changes recognized directly in the consolidated statement of income. Cost model requires that an investment property should be measured at depreciated cost less any accumulated impairment losses. Upon effectivity of PAS 40, the Company will adopt the cost model and will continue to carry its investment property at depreciated cost less any accumulated impairment losses. Adoption of this standard is not expected to have a material financial statement impact to the Company. New disclosures required by this standard will be included in the 2005 consolidated financial statements, as applicable.

- PFRS 3, "Business Combination," will result in the cessation of goodwill amortization and a requirement for an annual detailed test for goodwill impairment. Any resulting negative goodwill after performing reassessment will be credited to income. Moreover, pooling of interests in accounting for business combination will no longer be permitted. Upon effectivity, the Company will adjust the negative goodwill amounting to ₱72 (see Note 10) to January 1, 2005 retained earnings. Starting 2005, unamortized goodwill amounting to ₱77 (see Note 10) will be reviewed for impairment.

- PFRS 4, "Insurance Contract," specifies the financial reporting for all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. It provides limited improvements to accounting by insurers for insurance contracts. Adoption of PFRS 4 in 2005 will have no material financial statement impact to the Company.

The Company will also adopt in 2005 the following revised standards:

- PAS 1, "Presentation of Financial Statements," provides a framework within which an entity assesses how to present fairly the effects of transactions and other events; provides the base criteria for classifying liabilities as current or noncurrent; prohibits the presentation of income from operating activities and extraordinary items as separate line items in statement of income; and specifies the disclosures about key sources of estimation, uncertainty and judgments that management has made in the process of applying the entity's accounting policies. It also requires changes in the presentation of minority interest in the balance sheet and statement of income. Adoption of this standard in 2005 is not expected to have a material impact to the Company. The changes in the financial statement presentation as well as required disclosures will be included in the 2005 consolidated financial statements, as applicable.

- PAS 2, "Inventories," reduces the alternatives for measurement of inventories. It does not permit the use of the last in, first out (LIFO) formula to measure the cost of inventories. In the 2005 consolidated financial statements, the Company will change its inventory costing method for petroleum products (except for lubes and greases, waxes and solvents) from LIFO to first in, first out (FIFO) method. The impact of this change will be adjusted retroactively and is expected to increase retained earnings by about ₱513, ₱73 and ₱1,575 as of January 1, 2005, 2004 and 2003, respectively, and to increase inventories by about ₱754 and ₱107 as of December 31, 2004 and 2003, respectively.

- PAS 8, "Accounting Policies, Changes in Accounting Estimates and Errors," removes the concept of fundamental error and the allowed alternative to retrospective application of voluntary changes in accounting policies and retrospective restatement to correct prior period errors. It defines material omission or misstatements, and describes how to apply the concept of materiality when applying accounting policies and correcting errors. Adoption of this standard will not have a material financial statement impact to the Company.

- PAS 10, "Events After the Balance Sheet Date," provides a limited clarification of the accounting for dividends declared after the balance sheet date. Adoption of this standard will not have a material financial statement impact to the Company.

- PAS 16, "Property, Plant and Equipment," provides additional guidance and clarification on recognition and measurement of items of property, plant and equipment. It also provides that each part of an item of property, plant and equipment with a cost that is significant in relation to the total costs of the item shall be depreciated separately. It also requires that the cost of an item of property, plant and equipment should include the costs of its dismantlement, removal or restoration, the obligation for which the Company incurs as a consequence of installing the item or of using the item during a particular period for purposes other than to produce inventories during that period. The Company has yet to determine the impact of these new requirements as quantification will require detailed evaluation of significant items of property, plant and equipment as well as determination of the existence of any constructive and/or legal obligation related to the dismantlement, removal or restoration of certain of its property, plant and equipment. In the 2005 consolidated financial statements, the financial statement impact, if any, of these new provisions will be adjusted retroactively and prior years' consolidated financial statements will be restated accordingly.

- PAS 17, "Leases," provides a limited revision to clarify the classification of a lease of land and buildings and prohibits expensing of initial direct costs in the financial statements of the lessors. Adoption of this new provision will not have a material financial statement impact to the Company.

- PAS 24, "Related Party Disclosures," provides additional guidance and clarity in the scope of this standard, the definitions and disclosures for related parties. It also requires disclosure of the compensation of key management personnel by benefit type. New disclosures required by this standard will be included in the 2005 consolidated financial statements, as applicable.

- PAS 27, "Consolidated and Separate Financial Statements," reduces alternatives in accounting for subsidiaries in consolidated financial statements and in accounting for investments in the separate financial statements of a parent, venturer or investor. Investments in subsidiaries will be accounted for either at cost or in accordance with PAS 39 in the separate financial statements. Equity method of accounting will no longer be allowed in the separate financial statements. This standard also requires strict compliance with adoption of uniform accounting policies and requires the parent company to make appropriate adjustments to the subsidiary's financial statements to conform them to the parent company's accounting policies for reporting like transactions and other events in similar circumstances.

- PAS 31, "Interests in Joint Ventures," reduces the alternatives in accounting for interests in joint ventures in consolidated financial statements and in accounting for investments in the separate financial statements of a venturer. Interests in joint ventures will be accounted for either at cost or in accordance with PAS 39 in the separate financial statements.

  When the Company adopts PAS 27 and PAS 31 in 2005, its investments in subsidiaries and a joint venture will be accounted for under cost method in the separate financial statements. Accordingly, this will reduce the Parent Company's retained earnings by ₱943, ₱747 and ₱596 as of January 1, 2005, 2004 and 2003, respectively. The carrying amount of the investment will also be reduced by ₱943 and ₱747 as of December 31, 2004 and 2003 and net income will be reduced by ₱196, ₱151 and ₱165 in 2004, 2003 and 2002, respectively.

(Amounts in Millions, Except Par Value, Share and Per Share Amounts, Exchange Rates and Commodity Volumes)

The following new standards will also be adopted in 2005 but are expected to have no material financial statement impact to the Company.

- PAS 28, "Investments in Associates"
- PAS 33, "Earnings per Share"
- PFRS 1, "First-time Adoption of PFRS"
- PFRS 2, "Share-based Payments"
- PFRS 5, "Non-current Assets Held for Sale"

Basis of Consolidation and Investments

The consolidated financial statements comprise the financial statements of Petron and its subsidiaries as of December 31 of each year.

The purchase method of accounting is used for acquired businesses. Subsidiaries are consolidated from the date on which control is transferred to the Company and cease to be consolidated from the date on which control is transferred out of the Company.

The consolidated subsidiaries include:

Subsidiaries	Percentage of Ownership	Country of Incorporation
Ovincor	100	Bermuda
Petrogen Insurance Corporation (Petrogen)	100	Philippines
Petron Freeport Corporation (PFC, formerly Petron Treats Subic Inc.)	100	Philippines
Petron Marketing Corporation (PMC)	100	Philippines
New Ventures Realty Corporation and Subsidiary (NVRC)	79.95	Philippines

In the past, Petron, being partly foreign-owned, was not allowed by the Retail Trade Law to engage in direct retailing. Upon enactment of the Retail Trade Liberalization Act (RTLA), however, the Philippine Board of Investments has approved Petron's application to establish a retail enterprise, paving the way for the establishment of a direct-retailing subsidiary. On January 27, 2004, the Securities and Exchange Commission issued the Certificate of Incorporation to PMC. PMC operates company-owned, company-operated (COCO) service stations. The COCO stations will play a major part in launching market initiatives to strengthen the "Petron" brand and will give the Company the opportunity to quickly introduce innovations beyond the present services that are available in its stations.

The primary purpose of PFC and PMC is to, among others, sell on wholesale or retail, and operate service stations, retail outlets, restaurants, convenience stores and the like. PFC's service station started commercial operations in September 2004. PMC currently has 3 sites located in Dasmariñas Village, Makati; Filinvest, Alabang; and Carmen, Pangasinan, which started commercial operations in March, June and September 2004, respectively.

NVRC's primary purpose is to acquire real estate and derive income therefrom from its sale or lease. Petrogen and Ovincor are engaged in the business of insurance and re-insurance.

Minority interest in the net income of NVRC, which is not material, is included under "Bank charges and others" account in the consolidated statements of income. Minority interest, which represents the interest in NVRC not held by the Company, is included under "Other noncurrent liabilities" in the consolidated balance sheets.

Consolidated financial statements are prepared using uniform accounting policies for like transactions and other events in similar circumstances. Intercompany balances and transactions, including intercompany profits and unrealized profits and losses are eliminated.

Other investments are carried at cost. An allowance is provided for any substantial and presumably permanent decline in the carrying values of the investments.

Interest in Joint Venture

The Company's 33.33% joint venture interest in Pandacan Depot Services Inc (PDSI) (see Note 8), incorporated on September 29, 2004, is accounted for under the equity method of accounting. The interest in joint venture is carried in the 2004 consolidated balance sheet at cost plus post-acquisition changes in the Company's share of net assets of the joint venture, less any impairment in value. The 2004 consolidated statement of income reflect the Company's share in the results of operations of the joint venture.

Cash and Cash Equivalents

Cash includes cash on hand and in banks. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash with original maturities of three months or less from dates of acquisition and that are subject to an insignificant risk of change in value.

Investments in Marketable Equity Securities

Investments in marketable equity securities, shown under "Short-term investments" account in the consolidated balance sheets, are stated at the lower of aggregate cost or market value determined as of balance sheet date. The amount by which aggregate cost exceeds market value is accounted for as a valuation allowance and changes in the valuation allowance are included in the consolidated statements of income. Realized gains or losses from the sale of current marketable securities are included in the consolidated statements of income.

The cost of marketable equity securities used for determining the gain or loss on the sale of such securities is computed using the average method.

Receivables
Trade receivables are recognized and carried at original invoice amount less an allowance for any uncollectible amount. An estimate for doubtful accounts is made when collection of the full amount is no longer probable.

Inventories
Inventories are carried at the lower of cost or net realizable value. For petroleum products, crude oil and tires, batteries and accessories (TBA), the net realizable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion, marketing and distribution. For materials and supplies, net realizable value is the current replacement cost.

For financial reporting purposes, Petron uses the FIFO method in costing crude oil and other products and the LIFO method in costing petroleum products (except lubes and greases, waxes and solvents).

Cost is determined using the moving-average method in costing lubes and greases, waxes and solvents, TBA and materials and supplies inventories.

For income tax reporting purposes, all inventories are costed using the moving-average method.

For financial reporting purposes, duties and taxes related to the acquisition of inventories are capitalized as part of inventory cost. For income tax reporting purposes, such duties and taxes are treated as deductible expenses in the period these charges are incurred.

Property, Plant and Equipment
Property, plant and equipment, except land, are stated at cost less accumulated depreciation, amortization and any impairment in value. Land owned by NVRC and its subsidiary, is stated at cost less any impairment in value.

The initial cost of property, plant and equipment consists of its purchase price, including import duties and taxes and any directly attributable costs of bringing the assets to their working condition and location for its intended use. Cost also includes foreign exchange losses arising from the restatement of long-term foreign currency-denominated loans up to 2001 and interest incurred during the construction period on funds borrowed to finance the construction of the projects. Expenditures incurred after the property, plant and equipment have been put into operation, such as repairs, maintenance and overhaul costs, are normally charged to income in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as additional costs of property, plant and equipment. When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation, amortization and impairment loss, if any, are removed from the accounts and any resulting gain or loss is credited or charged to current operations.

For financial reporting purposes, depreciation and amortization are computed using the straight-line method over the following estimated useful lives of the assets:

Buildings and related facilities	20-25 years
Refinery and plant equipment	10-16 years
Service stations and other equipment	4-10 years
Computers, office and motor equipment	2-6 years
Leasehold improvements	10 years or the term of the lease, whichever is shorter

The useful life and depreciation and amortization method are reviewed periodically to ensure that the period and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment.

For income tax reporting purposes, depreciation and amortization are computed using the double-declining balance method.

For financial reporting purposes, duties and taxes related to the acquisition of property, plant and equipment are capitalized. For income tax reporting purposes, such duties and taxes are treated as deductible expenses in the period these charges are incurred.

Construction-in-progress represents plant and properties under construction and is stated at cost. This includes cost of construction, plant and equipment, interest and other direct costs. Construction-in-progress is not depreciated until such time as the relevant assets are completed and put into operational use.

Asset Impairment
The carrying values of long-lived assets are reviewed for impairment when events or changes in circumstances indicate that the carrying values may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amounts, the assets or cash-generating units are written down to their recoverable amounts. The recoverable amount of the asset is the greater of net selling price and value in use. The net selling price is the amount obtainable from the sale of an asset in an arm's length transaction. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessment of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognized in the consolidated statements of income.

Goodwill
Goodwill represents the excess of the cost of the acquisition over the Company's interest in the net fair value of acquired identifiable assets and liabilities of a subsidiary at the date of acquisition. Goodwill is stated at cost less accumulated amortization and any impairment in value. Goodwill is amortized on a straight-line basis over its useful economic life

up to a presumed maximum of 20 years. It is reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable. Goodwill amortization is included under "Bank charges and others" account in the consolidated statements of income.

Negative goodwill is the excess of the Company's interest in the net fair value of a subsidiary's identifiable assets and liabilities acquired over the cost of acquisition as of the date of exchange transaction. Negative goodwill is presented in the consolidated balance sheets as a deduction from the assets of the Company in the same presentation as goodwill.

Cylinder Deposits

The LPG cylinders remain the property of the Company and are loaned in the concept of commodatum to dealers upon payment by the latter of an equivalent 100% of acquisition cost of cylinders.

The Company maintains the balance of cylinder deposits at an amount equivalent to three days worth of inventory of its biggest dealers, but in no case lower than 200 million at any given time, to take care of possible returns by dealers.

Cylinder deposits, shown under "Other noncurrent liabilities" account in the consolidated balance sheets, are reduced for estimated non-returns. The reduction is credited directly to income.

Provisions

Provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

Revenue Recognition

Sale is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, title has transferred, selling price is fixed or determinable and collectibility of the selling price is reasonably assured. Interest is recognized on a time proportion basis that reflects the effective yield on the assets. Rental is accounted for on a straight-line basis over the lease term.

Borrowing Costs

Borrowing costs generally are expensed as incurred. For financial reporting purposes, interest on loans used to finance capital projects is capitalized as part of project costs (shown as part of construction-in-progress account) during construction period. Capitalization of interest commences when the activities to prepare the asset are in progress and expenditures and interest are being incurred. Interest costs are capitalized until the assets are substantially ready for their intended use. If the carrying amount of the asset exceeds its recoverable amount, an impairment loss is recognized. For income tax reporting purposes, such interest is treated as deductible expense in the period the interest is incurred.

Derivative Financial Instruments

The Company uses commodity price swaps to manage its margin on industrial fuel oil from potential price volatility of crude oil and industrial fuel oil. It also enters into short-term currency forward contracts to hedge its foreign currency exposure on crude oil importations. The gains or losses on these hedging instruments, including applicable premium amortization, are recognized in current operations simultaneous with the gains or losses on the underlying hedged transactions. In addition, the Company also enters into short-term currency swaps for liquidity purposes.

Pension Costs

Petron and its subsidiaries have a defined benefit pension plan covering all permanent, regular, full-time employees administered by trustee bank. Retirement costs are actuarially determined using the projected unit credit method. This method reflects services rendered by employees to the date of valuation and incorporates assumptions concerning employees' projected salaries. Retirement costs include current service cost plus amortization of past service cost, experience adjustments and changes in actuarial assumptions over the expected average remaining working lives of the covered employees. Valuation is made every year to update the plan costs and adjust the amount of contributions.

Operating Leases

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the consolidated statements of income on a straight-line basis over the lease term.

Foreign Currency-Denominated Transactions and Translations

Transactions in foreign currencies are recorded using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated using the spot exchange rate as of balance sheet date. Exchange gains or losses arising from foreign currency-denominated transactions are credited or charged to current operations, except for gains or losses arising from restatement of foreign currency-denominated loans used in the construction of property, plant and equipment, which were capitalized as part of the carrying amount of related assets up to 2001.

The financial statements of Ovincor have been translated into Philippine peso using the current rate method for purposes of consolidation. Under the current rate method, assets and liabilities are translated at spot exchange rate at year end, capital stock accounts at historical rates while revenues, expenses and other income and charges are translated using the average exchange rate. Differences resulting from translation are shown as accumulated translation adjustments (net of income tax) under the stockholders' equity section of the consolidated balance sheets.

Income Taxes

Deferred income tax is provided, using the balance sheet liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognized for all taxable temporary differences. Deferred income tax assets are recognized for all deductible temporary differences, carry forward of unused tax credits from excess minimum corporate income tax and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences and carryforward of unused tax credits and unused tax losses can be utilized. Deferred income tax, however, is not recognized when it arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of transaction, affects neither the accounting profit nor taxable profit or loss.

Deferred tax liabilities are not provided on non-taxable temporary differences associated with investments in domestic subsidiaries, associates and interests in joint ventures. With respect to investments in other subsidiaries, associates and interests in joint ventures, deferred tax liabilities are recognized except when the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Segments

The Company's operating businesses are recognized and managed separately according to the nature of the products and invoices provided, with each segment representing a strategic business unit that offers different products and serves different markets. Financial information on business and geographical segments is presented in Note 28.

Contingencies

Contingent liabilities are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote. A contingent asset is not recognized in the consolidated financial statements but disclosed when an inflow of economic benefits is probable.

Subsequent Events

Post-year-end events that provide additional information about the Company's position at the balance sheet date (adjusting events) are reflected in the consolidated financial statements. Post-year-end events that are not adjusting events are disclosed in the notes to the consolidated financial statements when material.

Earnings Per Share

Basic earnings per share is computed based on the weighted average number of outstanding shares after giving retroactive effect to any stock split and stock dividends declared during the year. There are no dilutive potential common shares outstanding that would require disclosure of diluted earnings per share in the consolidated statements of income.

3. Cash and Cash Equivalents

	2004	2003
Cash on hand and in banks	₱3,430	₱2,123
Money market placements	674	1,075
	₱4,104	₱3,198

Cash in banks earns interest at the respective bank deposit rates. Money market placements are made for varying periods of up to three months depending on the immediate cash requirements of the Company, and earn interest at the respective money market placement rates.

4. Short-term Investments

	2004	2003
Marketable equity securities - net	₱60	₱44
Short-term cash investments	3	25
	₱63	₱69

Marketable equity securities are carried at cost, net of allowance for decline in value amounting to ₱23 as of December 31, 2004 and ₱36 as of December 31, 2003.

	2004	2003
Gross unrealized gains from current marketable equity securities	₱59	₱20
Gross unrealized losses from current marketable equity securities	(82)	(56)
Net realized gain from current marketable equity securities included in net income	13	12

5. Receivables

	2004	2003 (As restated - see Note 2)
Trade	₱10,136	₱8,100
Others	2,397	1,970
	12,533	10,070
Less allowance for doubtful accounts	705	579
	₱11,828	₱9,491

(Amounts in Millions, Except Par Value, Share and Per Share Amounts, Exchange Rates and Commodity Volumes)

6. Inventories

	2004	2003
At cost:		
Petroleum	₱9,373	₱6,493
Crude oil and others	9,151	8,485
At net realizable value -		
TBA products, materials and supplies	711	696
	₱19,235	₱15,674

Using the moving-average method, the cost of petroleum products would have increased by ₱3,419 as of December 31, 2004 and ₱2,081 as of December 31, 2003.

Cost of TBA products, material and supplies amounted to ₱948 as of December 31, 2004 and ₱884 as of December 31, 2003.

7. Investments

	2004	2003
Notes and bonds - at amortized cost	₱330	₱273
Shares of stock - at cost	69	71
Joint venture interest in PDSI (see Note 8)	4	—
Other investments (net of allowance for decline in value of ₱580 in 2004 and ₱476 in 2003)	14	118
	₱417	₱462

Notes and bonds accounts are investments in government securities of Petrogen, which are deposited with the Insurance Commission in accordance with the provision of the Insurance Code, for the benefit and security of policy holders and creditors of Petrogen.

Other investments account includes Petron's matured investments with an institution under financial difficulty or receivership. In 2002, this was written down to ₱104 based on a rehabilitation or recovery program which has been drawn up for implementation by this institution.

In December 2003, the Company converted these investments into redeemable preferred voting shares in the institution pursuant to a court-approved rehabilitation plan. The preferred shares are redeemable on a pro-rata basis vis-à-vis other preferred shareholders beginning on the third year of operation of the institution, subject to certain conditions, until full payment of the total redemption value projected to be on the 18th year of the rehabilitation period. The equity investment was recorded at ₱104, the carrying amount of the matured investments at the time of conversion.

In December 2004, the Company provided additional allowance for decline for the remaining value of the investment amounting to ₱104 (see Note 18).

8. Investment in a Joint Venture

The Company has a 33.33% joint venture interest in PDSI, which is involved in receiving, storing and handling the out-loading of petroleum products of the three major oil companies to serve the fuel requirements of their respective customers. PDSI was incorporated on September 29, 2004 (see Note 7).

As of December 31, 2004, the carrying amount of the investment is ₱4. Financial information pertaining to PDSI as December 31, 2004 includes current assets amounting to ₱10, non-current assets amounting to ₱4 and current liabilities amounting to ₱10 (see Note 29d).

9. Property, Plant and Equipment

	Buildings and Related Facilities	Refinery and Plant Equipment	Service Stations and Other Equipment	Computers Office and Motor Equipment	Land and Leasehold Improvements	Construction-in-Progress	Total
Net carrying amount, at January 1, 2004	₱5,280	₱11,170	₱510	₱331	₱2,604	₱1,602	₱21,497
Additions	88		11	8	148	5,214	5,469
Reclassifications	583	174	171	163	37	(1,128)	-
Depreciation and amortization charges for the year	(373)	(1,335)	(167)	(116)	(113)	-	(2,104)
Net carrying amount, at December 31, 2004	₱5,578	₱10,009	₱525	₱386	₱2,676	₱5,688	₱24,862
At January 1, 2004							
Cost	₱7,156	₱20,142	₱2,767	₱1,508	₱3,371	₱1,602	₱36,546
Accumulated depreciation and amortization	(1,876)	(8,972)	(2,257)	(1,177)	(767)	-	(15,049)
Net carrying amount	₱5,280	₱11,170	₱510	₱331	₱2,604	₱1,602	₱21,497
At December 31, 2004	₱7,738	₱20,270	₱2,661	₱1,615	₱3,507	₱5,688	₱41,479
Cost							
Accumulated depreciation and amortization	(2,160)	(10,261)	(2,136)	(1,229)	(831)	-	(16,617)
Net carrying amount	₱5,578	₱10,009	₱525	₱386	₱2,676	₱5,688	₱24,862

Cumulative capitalized foreign exchange losses, net of depreciation, amounted to ₱2,182 as of December 31, 2004 and ₱2,411 as of December 31, 2003. No foreign exchange adjustment was capitalized in 2004 and 2003.

Interest capitalized in 2004 amounted to ₱98 using a capitalization rate of 8.24% for peso loans and 3.16% for dollar loans. Interest capitalized in 2003 amounted to ₱24 using a capitalization rate of 6.58%.

10. Other Noncurrent Assets

In 2003, this account includes the net balance of positive goodwill amounting to ₱9 arising from the increase in Petron's ownership in NVRC and NVRC's purchase of Las Lucas Development Corporation (Las Lucas).

In May 2003, the Company purchased additional shares of NVRC increasing its ownership from 50% to 79.95%. Details of this additional acquisition are as follows:

Fair value of net assets at acquisition date	₱483
Carrying value of investment	(383)
Deferred income tax liability	(28)
Negative goodwill	₱72

In 2002, shares of stock, under investments account in the consolidated balance sheet, include the downpayment amounting to ₱89 for the purchase by NVRC of 100% equity ownership in Las Lucas, an unlisted company registered in the Philippines. Total aggregate purchase price amounted to ₱301. The purchase was consummated on July 1, 2003.

The fair values of the identifiable acquired net assets of Las Lucas are:

Cash and cash equivalents	₱3
Land	315
Deferred income tax liability	(98)
Fair value of net assets	220
Goodwill arising on acquisition	81
Acquisition cost	₱301

The cash outflow on acquisition is as follows:

Cash acquired with subsidiary	₱3
Cash paid	(301)
Net cash outflow	(₱298)

The negative goodwill and goodwill arising from the increase in ownership in NVRC and NVRC's acquisition of Las Lucas, respectively, are presented in the 2003 consolidated balance sheet net of income tax effect amounting to ₱126 pertaining to the fair value adjustment on the land.

Goodwill is amortized over twenty years starting 2004. The movement in goodwill is as follows:

	2004	2003
Cost	₱81	₱81
Less: amortization during the year	4	-
Net book value	₱77	₱81

11. Short-term Loans

This account pertains to unsecured peso and dollar loans obtained from local banks at interest rates ranging from 7.0% to 9.0% for peso loans and 1.5% to 3.0% for dollar loans, intended to fund the importation of crude oil and petroleum products, capital expenditures and working capital requirements.

12. Accounts Payable and Accrued Expenses

	2004	2003 (As restated - Note 2)
Accounts payable	₱1,203	₱522
Accrued expenses	1,575	1,332
Specific and other taxes payable	482	438
Others	1,931	1,673
	₱5,191	₱3,965

Other payables include unearned income arising from trade related transactions.

13. Long-term Debt

	2004	2003
Syndicated dollar bank loan (net of debt issue costs amounting to ₱100 in 2004)	₱5,534	₱ -
Unsecured peso loans	3,288	4,000
	8,822	4,000
Less current portion	1,615	712
	₱7,207	₱3,288

The salient terms of the foregoing loans are summarized as follows:

Original Amount	NORD - LB US$100 million	Landbank - ₱2 billion	Citibank - ₱2 billion
Payment Terms	6 semi-annual installments starting on the 30th month from June 2004 up to June 2009	8 equal quarterly installments starting December 2004 up to September 2006	13 equal quarterly installments starting April 2004 up to April 2007
Interest (2004)	3.0% to 3.5%	9.0% to 10.0%	9.5% to 10.0%
Security	None	None	None
Major Covenants	Maintenance of certain financial ratios	None	Maintenance of certain financial ratios

(Amounts in Millions, Except Par Value, Share and Per Share Amounts, Exchange Rates and Commodity Volumes)

As of December 31, 2004, the Company is in compliance with its loan covenants.

Loan maturities (gross of ₱100 debt issue costs) for the next 5 years are as follows:

Year	Amount
2005	₱1,615
2006	1,929
2007	1,857
2008	2,254
2009	1,267
	₱8,922

14. Other Noncurrent Liabilities

	2004	2003
Cylinder deposits	₱274	₱256
Minority interest	110	103
Others	31	41
	₱415	₱400

15. Stockholders' Equity

a. Capital Stock

	Number of Shares	Amount
Authorized - 1.00 par value	10,000,000,000	₱10,000
Issued and outstanding	9,375,000,000	₱9,375

b. Retained Earnings

i. This account includes Petron's accumulated equity in net earnings of subsidiaries and a joint venture of ₱943 in 2004 and ₱747 in 2003, which are not currently available for dividend declaration.

ii. Declaration of Cash Dividends
In 2004, the Company declared a cash dividend of ₱0.20 per share amounting to ₱1,875 to all stockholders of record as of May 19, 2004. In 2003, a cash dividend of ₱0.20 per share amounting to ₱1,875 was declared to all stockholders of record as of May 29, 2003. In 2002, a cash dividend of ₱0.15 per share amounting to ₱1,406 was declared to all stockholders of record as of June 6, 2002.

iii. Appropriation for Capital Projects
Petron appropriated ₱1,355 in 2004 and ₱939 in 2002 for future capital projects.

16. Income Taxes

The significant components of deferred income tax assets and liabilities are as follows:

	2004	2003 (As restated - Note 2)
Deferred tax assets:		
Inventory differential	₱1,095	₱657
Rental - net	174	171
Unamortized past service pension costs	38	49
Unrealized foreign exchange loss	18	13
Various allowances, accruals and others	468	383
	1,793	1,273
Deferred tax liabilities:		
Excess of double declining over straight-line method of depreciation and amortization	₱1,098	₱1,074
Capitalized foreign exchange losses	570	627
Capitalized taxes and duties on inventories deducted in advance	431	348
Fair market value adjustment on and in a purchase acquisition	126	126
Capitalized interest, duties and taxes on property, plant and equipment deducted in advance and others	450	305
	2,675	2,480
	₱882	₱1,207

The reconciliation of provision for income tax computed at the applicable statutory income tax rate to provision for income tax as shown in the consolidated statements of income is summarized as follows:

	2004	2003 (As restated - see Note 2)	2002
Income tax computed at statutory income tax rate	₱1,420	₱1,318	₱1,330
Additions (reductions) resulting from:			
Income subject to income tax holiday (see Note 27)	(410)	(288)	(117)
Provision (reversal of allowance) for decline in value of investments	29	(4)	(2)
Interest income subjected to lower final tax and others	(25)	(21)	23
Provision for income tax	₱1,014	₱1,005	₱1,234

Provision for income tax includes final withholding tax on interest income.

17. Cost of Goods Sold

	2004	2003	2002
Direct materials	₱133,838	₱98,444	₱80,750
Depreciation and amortization	1,261	1,190	1,180
Employee costs	353	330	345
Others	1,225	1,389	1,193
	₱136,677	₱101,353	₱83,468

18. Operating Expenses

	2004	2003	2002 (As restated-see Note 2)
Selling and administrative:			
Employee costs	**₱1,218**	₱979	₱920
Depreciation and amortization	**843**	924	1,104
Purchased services and utilities	**646**	430	494
Maintenance and repairs	**545**	467	378
Advertising	**403**	227	277
Rental (see Note 20)	**271**	260	265
Materials and office supplies	**260**	46	245
Taxes and licenses	**177**	197	111
Provision for doubtful accounts/ accounts receivable written-off	**162**	-	65
Insurance	**71**	47	65
Entertainment, amusement and representation	**16**	14	13
	4,612	3,591	3,937
Other operating charges (income):			
Rental	**(274)**	(276)	(250)
Price adjustments	**202**	199	-
Others	**343**	323	(175)
	271	246	(425)
	₱4,883	₱3,837	₱3,512

19. Interest

	2004	2003	2002
Interest income on:			
Marketable equity securities	**₱180**	₱117	₱130
Trade receivables	**124**	33	17
Product loaning	**28**	21	23
Cash in banks	**8**	58	59
Investment bonds	**2**	4	21
Others	**2**	2	7
	344	235	257
Interest expense on:			
Loans	**(1,336)**	(1,459)	(1,068)
Product borrowings	**(87)**	(34)	-
Others	**(16)**	-	-
	(1,439)	(1,493)	(1,068)
	(₱1,095)	(₱1,258)	(₱811)

20. Related Party Transactions

The significant transactions with related parties are as follows:

2004

Name of Company	Relationship	Nature of Transaction	Transaction Amount	Balance at end of Year
Saudi Aramco	**Stockholder**	**Crude purchases**	**₱73,711**	**₱3,963**
Philippine National Oil Company (PNOC)	**Stockholder**	**Leases**	**142**	**-**

2003

Name of Company	Relationship	Nature of Transaction	Transaction Amount	Balance at end of Year
Saudi Aramco	Stockholder	Crude purchases	₱62,915	₱3,386
PNOC	Stockholder	Leases	127	-

a. Petron and Saudi Arabian Oil Company (Saudi Aramco) have a term contract to purchase and supply, respectively, 90% of Petron's monthly crude oil requirements over a 20-year period at Saudi Aramco's standard Far East selling prices. Outstanding liabilities of Petron for such purchases are shown as part of "Liabilities for crude oil and petroleum product importation" account in the consolidated balance sheets.

b. Petron has long-term lease agreements with PNOC until August 2018 covering certain lots where its refinery and other facilities are located. Lease charges on refinery facilities escalate at 2% a year, subject to increase upon reappraisal (see Note 21).

21. Operating Lease Commitments

Company as lessee

Future minimum rental payable under the non-cancellable operating lease agreements as of December 31 follows:

	2004	2003
Within one year	**₱382**	₱365
After one year but not more than five years	**1,508**	1,509
After five years	**3,102**	3,483
	₱4,992	₱5,357

(Amounts in Millions, Except Par Value, Share and Per Share Amounts, Exchange Rates and Commodity Volumes)

Company as lessor

Future minimum rental receivable under the non-cancelable operating lease agreements as of December 31 follows:

	2004	2003
Within one year	₱195	₱251
After one year but not more than five years	220	387
After five years	161	180
	₱576	₱818

22. Pension Plan

Petron and its subsidiaries maintain a qualified, non-contributory, trusteed pension plan covering substantially all permanent, regular, full-time employees.

Actuarial valuation is obtained for the plan every year. As of the most recent valuation date of the Company's pension plan (December 31, 2004), the fair value of the plan assets amounted to ₱3,419. The actuarial present value of pension benefits, based on the discount rate of 12%, amounted to ₱2,564. The excess of the fair value of the plan assets over the actuarial present value of pension benefits amounted to ₱855. Other principal actuarial assumptions used to determine retirement benefits include an expected long-term rate of return on plan assets of 10%, discount rate of 12 % and average salary increase rate of 9%.

No pension expense was provided in 2004, 2003 and 2002.

23. Supplementary Information

a. Processing License Agreement

Petron was granted by Pennzoil-Quaker State International Corporation (Pennzoil) another 5 years of exclusive right to manufacture, sell and distribute in the Philippines certain Pennzoil products until December 31, 2008. The agreement also includes the license to use certain Pennzoil trademarks in exchange for the payment of royalty fee based on net sales value. Royalty expense amounted to ₱1.20 in 2004 and ₱1.55 in 2003 and ₱1.97 in 2002 are included as part of cost of sales account in the consolidated income statements.

b. Fuel Supply Contract with National Power Corporation (NPC)

The Company entered into various fuel supply contract with NPC commencing on March 1, 2004 until December 31, 2004. Under the agreement, the Company supplies the bunker fuel and diesel fuel oil requirements to selected NPC plants and NPC-supplied Independent Power Plants.

In the bidding held last March 18 to 23, 2004 for NPC fuel requirements, Petron won a total of 39,922 kilo-liters (KL) of diesel fuel and 555,919 KL of bunker fuel worth ₱671 and ₱6,039, respectively.

NPC exercised its option to extend the supply period of the power plants covered under the year 2004 contract up to a maximum of six (6) months since the contracted quantities have not been fully lifted by December 31, 2004. Petron's contract with NPC allows for continued lifting of fuel until the contracted quantities are lifted, provided the extension does not exceed six months.

After the mutual agreement between the Company and NPC, the years 2002-2003 contract for NPC's Small Power Utilities Group Power Plants has been extended up to February 28, 2005.

Sales from the above transactions amounted to ₱11,453 in 2004, ₱7,769 in 2003 and ₱6,529 in 2002.

24. Earnings Per Share (EPS)

	2004	2003	2002
		(As restated - see Note 2)	
Net income	₱3,425	₱3,114	₱2,921
Weighted average number of shares	9,375,000,000	9,375,000,000	9,375,000,000
EPS	₱0.37	₱0.33	₱0.31

25. Supplemental Disclosures of Cash Flow Information

a. Changes in operating assets and liabilities

	2004	2003	2002
		(As restated - see Note 2)	
Decrease (increase) in assets:			
Trade receivables	(₱2,502)	(₱268)	(₱1,062)
Inventories	(3,561)	(4,304)	69
Other current assets	(23)	(163)	(254)
Increase (decrease) in liabilities:			
Liabilities for crude oil and petroleum product importation	(445)	1,825	1,702
Accounts payable and accrued expenses	718	(73)	(400)
	(5,813)	(2,983)	55
Provisions (reversal of allowance) for doubtful accounts, inventory obsolescence and others	531	199	(175)
	(₱5,282)	(₱2,784)	(₱120)

b. Acquisition of a subsidiary by NVRC

The fair values of the identifiable acquired net assets of Las Lucas in 2003 are:

Cash and cash equivalents	₱3
Land	315
Goodwill	81
Deferred income tax liability	(98)
Total purchase price	301
Advances made in 2002	(89)
Cash and cash equivalents	(3)
Cash flow on acquisition, net of cash acquired	₱209

26. Financial Instruments

The Company uses IFO-Dubai crack spread swaps to protect its margin on export and domestic sales of industrial fuel oil products. The cost base of the Company's industrial fuel is that of the crude oil, most of which is supplied by Saudi Aramco and is priced based on Dubai/Oman crude price. On the other hand, the selling price of the industrial fuel is based on Singapore's Mean of Platts (MOPS). Under the crack spread swap, the Company and its counterparties agree to a monthly exchange of cash settlements based on a specified reference price, depending on the commodity being hedged. For the IFO portion of the crack spread swap that hedges the price risks on industrial fuel oil products, the Company acts as the floating rate payer and the reference price index is the monthly MOPS for HSFO 180 CST. For the Dubai portion that hedges the price risks on crude oil, the Company acts as the fixed rate payer and the reference price index is the monthly average for Platt's Dubai Crude. The swap agreements effectively hedge the Company's margin on industrial fuel oil.

As of December 31, 2003, the Company has outstanding commodity price swaps covering industrial fuel oil with an aggregate notional quantity of 64,614 metric tons (MT), and a weighted average fixed rate of US$156.78 per MT, respectively. The net mark-to-market losses on these swaps amounted to ₱32 in 2003. As of December 31, 2004, there are no such outstanding contracts. Also, as of December 31, 2003, the Company has outstanding commodity price swaps covering Dubai crude oil with an aggregate notional quantity of 420,000 barrels, and a weighted average fixed rate of US$25 per barrel. The net mark-to-market gains on these swaps amounted to ₱66 as of December 31, 2004, there are no such outstanding contracts.

The Company also entered into deliverable and non-deliverable short-term currency forward contracts to hedge its foreign currency exposure on crude oil importations. As of December 31, 2003, the Company has outstanding currency forward contracts with an aggregate notional amount of US$55, and weighted average contracted forward rate of ₱55.75 to US$1.00. The net mark-to-market losses on these currency forward contracts amounted to ₱0.67. As of December 31, 2004, the Company has no outstanding deliverable and non deliverable short-term currency forward contracts.

Under current accounting practice, the unrealized mark-to-market losses on the outstanding derivative contracts as of December 31, 2004 and 2003 are presented for disclosure purposes only and are not included in the determination of net income.

27. Registration with the Board of Investments (BOI)

Petron is registered with the BOI under the New Omnibus Investments Code of 1987 (Executive Order 226) as a pioneer, new producer status of Mixed Xylene. Under the terms of its registration, Petron is subject to certain requirements, principally that of producing required metric tons of Mixed Xylene every year.

As a registered enterprise, Petron is entitled to the following benefits on its Mixed Xylene operations:

a. Income Tax Holiday (ITH) for six years from actual start of Mixed Xylene commercial operations (December 1999);

b. Tax credits for taxes on duties on raw materials and supplies used for its export products and forming parts thereof; and,

c. Simplified custom procedures and others.

Petron has availed of ITH credits amounting to ₱410 in 2004, ₱288 in 2003 and ₱117 in 2002.

In October 2003, the BOI approved Petron's application under Republic Act 8479, otherwise known as the Oil Deregulation Law, for new investments at its Bataan Refinery for an Isomerization Unit and a Gas Oil Hydrotreater (Project). The BOI is extending the following major incentives:

a. ITH for five years without extension or bonus year from actual start of commercial operations (January 2005);

b. Duty of three percent and value added tax (VAT) on imported capital equipment and accompanying spare parts;

c. Exemption from real property tax on production equipment or machinery; and,

d. Exemption from contractor's tax.

Petron has requested for clarification and possible amendment of the terms and conditions of the Project's BOI registration, mainly with respect to the ITH rate formula and the VAT rate on imported capital. To date, BOI has yet to issue its final ruling.

28. Segment Information

The Company's operating businesses are organized and managed according to the nature of the products marketed, with each segment representing a strategic business unit that offers different products and serves different markets.

The Company's major sources of revenues are as follows:

a. Sales from petroleum and other related products which include gasoline, diesel, and kerosene offered to motorists and public transport operators through its service station network around the country;

b. Insurance premiums from the business and operation of all kinds of insurance and reinsurance, on sea as well as on land, of properties, goods and merchandise, of transportation or conveyance, against fire, earthquake, marine perils, accidents and all other forms and lines of insurance authorized by law, except life insurance; and,

c. Lease of acquired real estate properties for petroleum, refining, storage and distribution facilities, gasoline service stations and other related structures.

(Amounts in Millions, Except Par Value, Share and Per Share Amounts, Exchange Rates and Commodity Volumes)

d. Sell on wholesale or retail, and operate service stations, retail outlets, restaurants, convenience stores and the like.

The following tables present revenue and income information and certain asset and liability information regarding the business segments for the years ended December 31, 2004 and 2003. Segment assets and liabilities exclude income tax assets and liabilities.

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
Year Ended December 31, 2004						
Revenue:						
Total revenue	₱147,356	₱531	₱249	₱663	(₱1,374)	₱147,425
Segment results	5,633	505	229	-	(502)	5,865
Net income	3,425	158	31	13	(202)	3,425
Assets and liabilities:						
Segment assets	61,006	1,222	2,324	416	(3,551)	61,417
Segment liabilities	39,032	137	1,674	77	(1,609)	39,311
Other segment information:						
Property, plant and equipment	22,458	2	2,157	160	85	24,862
Depreciation and amortization	2,095	-	2	7	-	2,104
Year Ended December 31, 2003						
Revenue:						
Total revenue	₱110,737	₱527	₱224	₱-	(₱751)	₱110,737
Segment results	5,349	504	206	-	(512)	5,547
Net income	3,114	130	33	(1)	(162)	3,114
Assets and liabilities:						
Segment assets	50,740	1,129	2,198	50	(2,916)	51,201
Segment liabilities	29,994	210	1,579	1	(1,460)	30,324
Other segment information:						
Property, plant and equipment	19,375	2	2,034	-	86	21,497
Depreciation and amortization	2,112	-	2	-	-	2,114

The following tables present additional information on the petroleum business segment of the Company for 2004 and 2003:

	Retail	Lube	Gasul	Industrial	Others	Total
Year Ended December 31, 2004						
Revenue	₱65,075	₱1,107	₱7,650	₱54,594	₱18,930	₱147,356
Property, plant and equipment	4,590	12	206	65	17,585	22,458
Capital expenditures	577	2	37	21	4,996	5,633
Year Ended December 31, 2003						
Revenue	₱48,676	₱947	₱6,415	₱36,438	₱18,261	₱110,737
Property, plant and equipment	4,046	12	38	62	15,217	19,375
Capital expenditures	695	1	6	35	865	1,602

Geographical segments

The following tables present revenue and expenditure and certain asset information regarding the geographical segments of the Company for the years ended December 31, 2004 and 2003:

	Petroleum	Insurance	Leasing	Marketing	Elimination/ Others	Total
Year Ended December 31, 2004						
Revenue:						
Local	₱134,275	₱463	₱249	₱660	(₱1,371)	₱134,276
Export/International	13,081	68	-	-	-	13,149
Year Ended December 31, 2003						
Revenue:						
Local	₱96,472	₱470	₱224	₱-	(₱751)	₱96,415
Export/International	14,265	57	-	-	-	14,322

29. Other Matters

a. In 1998, the Company contested before the Court of Tax Appeals (CTA) the collection by the Bureau of Internal Revenue (BIR) of deficiency excise taxes amounting to ₱1,108 representing back taxes, surcharge and interest arising from the Company's acceptance and use of Tax Credit Certificates (TCCs) worth ₱659 from 1993 to 1997. In July 1999, the CTA ruled that, as a fuel supplier of BOI-registered companies, the Company was a qualified transferee for the TCCs. The CTA ruled that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. The BIR appealed the ruling to the CTA where the case is still pending.

   In November 1999, the Department of Finance (DOF) Center ExCom cancelled Tax Debit Memos (TDMs) worth ₱475, the related TCCs and their assignments. The BIR implemented this with a letter of assessment worth ₱651 deficiency taxes (inclusive of interest and charges) for the years 1995 to 1997, as a result of the cancellation. The Company contested on the grounds that the assessment has no factual and legal basis and that the cancellation of the TDMs was void. The Company elevated this protest to the CTA on July 10, 2000 where the case is still pending.

   In January 2002, the BIR issued another assessment worth ₱739 deficiency taxes (inclusive of interest and charges) for the years 1995 to 1998, as a result of the cancellation of TCCs and TDMs by the DOF Center ExCom. The Company protested this assessment on the same legal grounds used against the tax assessment issued by the BIR in 1999. The Company elevated the protest to the CTA where the case is pending.

   In the TCC-related criminal cases, two of which have been filed by the Office of the Ombudsman with the Sandiganbayan and four are currently with the Ombudsman on Preliminary Investigation, Petron officials are uniformly charged or accused of having conspired with former officials of DOF One-Stop-Shop Center, BIR and the Bureau of Customs (BOC) and with private individuals to defraud the government by accepting fraudulently issued TCCs and thereafter, by using these TCCs in payment of taxes. The Petron officers had acted on or signed the Deeds of Assignment in official capacities. The Company continues to express its full confidence in the integrity of its officers and employees, former and current. The Company therefore expects that the charges against these Petron officers and employees will be dismissed.

   The Company maintains that it has not been involved in the issuance of these TCCs and that it had relied on the approval by the DOF and the BIR with respect to the issuance, the assignment and the use of these TCCs. The Company and its officers maintain that they have not gained any undue advantage in any of the TCC transaction and for each TCC that was duly assigned and accepted the Company issued an equivalent credit note that was used to pay for fuel products of the Company.

   Petron officers who were already arraigned in the first Sandiganbayan case went up to the Supreme Court (SC) after the Sandiganbayan reversed an earlier ruling dismissing the case for failure on the part of the Ombudsman to prosecute.

b. Petron has unused letters of credit totaling approximately ₱12 as of December 31, 2004 and ₱4 as of December 31, 2003.

c. Implementation of RA No. 8749, "Philippine Clean Air Act of 1999"

   Petron has been fully complying with the Clean Air Act (CAA) since the law was implemented. It introduced its low-sulfur "Diesel Max" to the market three months ahead of the CAA-mandated schedule. Under the CAA law, oil firms are mandated to lower the sulfur content of ADO to 0.05% by January 1, 2004 nationwide.

   Beyond CAA compliance, Petron is the only oil company that has invested substantial resources to upgrade its production capabilities to meet CAA specifications. It recently commissioned in January 2005 its Isomerization Unit that will enable the Company to produce isomerates for blending with gasoline to meet current specifications. The unit is part of the $100 million refinery project that also includes a Gas Oil Hydrotreater. With these two units, Petron will be the only oil firm that can serve the local market's demand for CAA-compliant fuels entirely from local production.

d. Pandacan Terminal Operations

   The City Council of Manila (City Council), citing concerns of safety, security and health, passed City Ordinance No. 8027 reclassifying the areas occupied by the Oil Terminals of Petron, Shell and Caltex from Industrial to Commercial, making the operation of the terminals therein unlawful.

   In an effort to address the concerns of the City Council, the oil companies implemented a Scale Down Program to reduce tankage capacities, create buffer zones and consolidate operation of their facilities. The Petron Linear Park was inaugurated last December 17, 2003. This serves as additional safety and security buffer zone, further enhancing the safety of the facility.

Of the 28 tanks that were committed to be dismantled under the Memorandum of Understanding signed between the three oil companies, the Department of Energy and the City of Manila, 26 have been decommissioned/dismantled. The dismantling of the remaining two tanks is contingent upon full integration of the Pandacan Operations.

To date, the first phase of the engineering, procurement and construction is already more than 93% complete. On the other hand, the second phase of the engineering, procurement and construction is 25% complete.

The Joint Venture (PDSI) took over the operations of the "scaled-down" facility on November 1, 2004 after the City of Manila issued the business permit applied for.

Simultaneous with the Scale Down Program, Petron filed a petition with the Regional Trial Court (RTC) to annul the City Ordinance and enjoin the City Council of Manila, as well as Mayor of Manila, from implementing the same. The RTC issued a status quo order which prevents the respondents from enforcing the Ordinance until further orders of the Court or termination of the case. The case has been referred to and is undergoing mediation before the Philippine Mediation Center.

e. Navotas Business Tax

In the case of Petron vs. Mayor Tobias Tiangco concerning the imposition of business tax for the sale of diesel at the Navotas Bulk Plant, the Temporary Restraining Order issued by the SC is still in effect and will prevent the closure of the Bulk Plant until the case is decided by the SC.

f. Ownership of LPG Cylinders in the Market

Liquefied Petroleum Gas Marketers Association (LPGMA), a group of independent refillers of LPG claims to have acquired ownership of LPG cylinders of Petron, Pilipinas Shell and Total Philippines in good faith. LPGMA claims it can exercise all rights of ownership over the cylinders, praying judgment from the RTC of Pasig City authorizing its members to repaint/obliterate the marks on the oil companies' LPG cylinders and all LPG cylinders which now or in the future may come into their possession; or to compel the parties to enter into a swapping arrangement and/or compelling the oil companies to buy back the cylinders.

The case is currently pending before the RTC.

List of Banks and Financial Institutions

Banco de Oro
Bank of the Philippine Islands
BDO Private Bank
China Banking Corporation
Chinatrust (Phils.) Commercial Bank Corporation
Development Bank of the Philippines
Equitable PCI Bank
PCI Capital Corporation
Land Bank of the Philippines
Metropolitan Bank and Trust Company
Philippine National Bank
Rizal Commercial Banking Corporation
Security Bank Corporation
Union Bank of the Philippines
United Coconut Planters Bank
ABN Amro Bank
Australia and New Zealand Banking Group, Ltd.
BNP Paribas
Citibank, N. A.
Calyon Corporate and Investment Bank
Deutsche Bank
The Hong Kong and Shanghai Banking Corporation, Ltd.
ING Bank, N. V.
JP Morgan Chase Bank
The Bank of Tokyo-Mitsubishi, Manila Branch

Arab Petroleum Investment Corporation
Bank of China
Banque Saudi Fransi
Bumiputra Commerce Bank
Cathay United
Chiao Tung Bank
Chinatrust Commercial Bank
Citibank International Limited
International Commercial Bank of China
Norddeutsche Landesbank Girozentrale, Singapore
Saudi American Bank
The Saudi Investment Bank

Board of Directors

Nicasio I. Alcantara, 62, has been a Director and Chairman of Petron since July 2001. Serves as Chairman and/or President of various corporations of the Alcantara Group of Companies.

Khalid D. Al-Faddagh, 49, has been a Director since July 2001 and President of the Company since July 29, 2003. Has over 20 years experience in various professional and management positions in Saudi Aramco.

Bernardino R. Abes, 74, has been a non-executive Director of the Company since July 2001. Also serves as the Chairman of the Government Service Insurance System, a Director of Belle Corporation, and a Director of Union Bank of the Philippines.

Basil A. Abul-Hamayel, 39, has been a Director of the Company since July 2004 and is currently its Vice-President for Corporate Planning Division since April 2004. Has 21 years of service with Saudi Aramco.

Khalid G. Al-Buainain, 46, has been a non-executive Director of the Company since July 29, 2003. Currently acts as the Vice-President for Refining of Saudi Aramco, the Chairman of Luberef and a member of the Saudi Aramco Executive Advisory Committee.

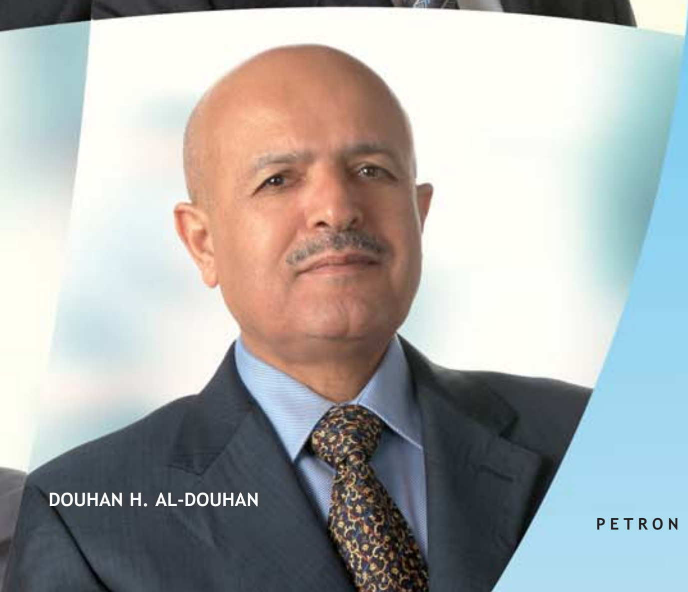
Motassim A. Al-Ma'ashouq, 44, has been Director since September 2000. Is presently the Assistant Treasurer of Saudi Aramco. Was the Company's President from 2000 to 2003 and Chief Executive Officer from September 2000 until July 2002.

Herminio S. Aquino, 55, Director of the Company since November 2004. Is currently the Chairman and President of Buenavista Management Corporation and Chairman of Trackworks, Inc. and 7-Series, Inc.

Alberto A. Pedrosa, 72, was elected Director of the Company last March 2005. He is currently the Chairman and Publisher of Republika, a news magazine.

Douhan H. Al-Douhan, 69, has been an independent Director since July 2001. Is currently the Managing Director of Randa Trading & Construction in Saudi Arabia.

Jose Luis U. Yulo, Jr., 57, has been an independent Director since July 2001. Is currently the Chairman of Insurance of the Philippine Islands Co., Inc., and President of Centrex Corporation, One Card International Co., Inc. and Majesta Property Holdings.



Management Committee and Executive Officers

Nicasio I. Alcantara
Chairman

Khalid D. Al-Faddagh
President and Chief Executive Officer

Jose K. Campos, Jr.
Vice President for Marketing

Alfred A. Trio
Vice President for Refinery

Basil A. Abul-Hamayel
Vice President for Corporate Planning

Antonio G. Pelayo
Vice President for Finance and Subsidiaries

Felimon E. Antiporta
Officer-in-Charge for Supply and Operations

Rosario R. Eijansantos
Treasurer

Luis A. Maglaya
Corporate Secretary

Ma. Concepcion F. de Claro
Controller


JOSE K. CAMPOS, JR.
ALFRED A. TRIO
ANTONIO G. PELAYO
BASIL A. ABUL-HAMAYEL
MA. CONCEPCION F. DE CLARO
FELIMON E. ANTIPORTA

LUZON

APARRI
J.P. de Carreon St. Punta
Aparri, Cagayan
(078) 888-2456/888-2071

BATANGAS
Bo. Mainaga, Mabini, Batangas
(043) 487-0418/ 487-0377
(043) 487-0419 (Fax)

LIMAY
Petron Bataan Refinery
Limay, Bataan
(02) 886-3187-96 loc.390-394

CALAPAN
Roxas St. Brgy. Ilaya
Calapan City, Oriental Mindoro
(043) 288-1779

PASACAO
Brgy. Camangi
Pasacao, Camarines Sur
(054) 513-9258/513-9175
(054) 513-9175 (Fax)

PALAWAN
Parola, Brgy. Maunlad
Puerto Princesa City, Palawan
(048) 433-2682/433-3329

PORO
Poro Pt.
San Fernando, La Union
(072) 242-6032/33 to 2426034

ROSARIO
Gen. Trias, Rosario, Cavite
(046) 438-2860/438-1996

NAVOTAS
PFDA Compound Navotas
Metro Manila
(02) 281-4826/281-1297

SAN JOSE
1020 A. Mabini St.
San Jose, Occidental Mindoro
(043) 491-1938

VISAYAS

AMLAN
Tandayag, Amlan, Negros Oriental
(035) 527-0790/527-0159
(035) 417-0793/417-0794

TACLOBAN
Anibong, Tacloban City
(053) 325-6433/325-6432/325-6448

BACOLOD
Bo. San Patricio
Bacolod City, Negros Occidental
(034) 433-9690/433-9687 to 89

ILOILO
Lapuz, Iloilo City
(033) 337-6895/338-1893

ISABEL
LIDE, Isabel, Leyte
(053) 556-0177/337-2289

MANDAUE
Looc, Mandaue City, Cebu
(032) 346-5135/344-7341 to 51

ORMOC
Bo. Linao, Ormoc City, Leyte
(053) 255-4579/561-1239/255-2152

ROXAS
Arnaldo Blvd., Culasi, Roxas City
(036) 621-1992/621-0722/621-5789

TAGBILARAN
Graham Ave., Tagbilaran, Bohol
(038) 411-3397

MINDANAO

TAGOLOAN
Tagoloan, Misamis Oriental
(08822) 740072

DAVAO
Sasa, Davao City, Davao del Sur
(082) 234-2185 to 86/233-0399/
234-2185

GENERAL SANTOS
Bula Morrow Blvd, Gen. Santos City
(083) 301-1988

BAWING
Bawing, General Santos City
(083) 380-7725/380-7726

ILIGAN
Bo. Tuminobo
Iligan City, Lanao del Norte
(063) 492-0653/516-704/221-5264

JIMENEZ
Jimenez, Misamis Occidental
(088) 272-3230/272-3243

NASIPIT
Talisay, Nasipit, Agusan del Norte
(085) 283-3126/343-2218 to 19

PARANG
Parang, Maguindanao, Cotabato
(064) 425-0025/425-0070

ZAMBOANGA
Lower Calarian, Zamboanga City
(062) 991-1245/991-1571/991-4352

PANDACAN
Jesus St., Pandacan, Manila
Order & Billing
563-8491 to 95

Dispatching
563-3047/563-8521 loc 223

CALAMBA
Calamba, Laguna
(049) 545-6481

AIRPORT INSTALLATIONS

NAIA
JOCASP, CPD, NAIA, Pasay City
(02) 833-7084/831-5842

LAOAG
Laoag Airport
c/o NAIA 833-7084

MACTAN
MEPZ, Lapu-lapu City
(032) 340-4620/340-4629

DAVAO
Davao Airport
(082) 234-2185 to 86/233-0399/234-1582

LPG OPERATIONS

GASUL-PASIG
Bo. Ugong, Pasig, Metro Manila
DL: 671-2687/TL: 671-9817

LEGASPI
Lakandula Drive, Brgy. Bonot
Legaspi City, Albay
(052) 480-8113

GASUL-SAN FNDO
San Fernando, Pampanga
(045) 961-3564

Products

FUELS

Automotive Gasoline
Blaze
XCS Plus with Valvemaster™
Premium Unleaded with XCS
Regular Unleaded

Diesel Fuels
Petron Diesel Max
Petron Industrial Diesel Fuel

Industrial Fuels
Petron Fuel Oil
IF-1
Intermediate Fuels
Special Fuel Oil

Aviation Fuels
Aviation Gasoline
Jet A- I

Household Fuels
Gasul
Gaas

AUTOMOTIVE LUBRICATING OILS

Diesel Engine Oils
Rev-X All Terrain
Rev-X Trekker
Rev-X Hauler
Rev-X HD
Petron HDX
Petron XD3
Petron XD 2040
Petron 2040
Petron Railroad Extra

Gasoline Engine Oils
Ultron Race
Ultron Rallye
Ultron Touring
Ultron Extra
Petron MO

Motorcycle Oils
Petron Sprint 4T
2T Premium
2T Enviro
2T Autolube
2T Powerburn

Others
STM

Automotive Gear Oils
Petron GX
Petron GEP
Petron GST

Automotive Transmission Fluids
Petron ATF Premium
Petron TF 38
Petron TDH 50

INDUSTRIAL LUBRICATING OILS

Turbine, Hydraulic and Circulating Oils
Hydrotur AWX
Hydrotur AW
Hydrotur AW (GT)
Hydrotur EP 46
Hydrotur N 100
Hydrotur R
Hydrotur SX 32
Hydrotur SX 68
Hydrotur SX 220
Hydrotur T
Hydrotur TEP

Industrial Gear Oils
Hypex EP (Oil-Based)
Hypex EP (Asphalt-Based)
Milrol 5K
Gearfluid
Gearkote

Cutting Oils
Turnol
Petrokut 10
Petrokut 27

Refrigeration Oils
Zerflo 68
Suniso

Other Industrial Lubricating Oils
Petrocyl S
Petrocyl
Airlube
Spinol 15
Spinol 10E
Petrosine 68
Voltran 60

MARINE LUBRICATING OILS

Marine Cylinder Oils
DCL 100
Petromar S

Marine Trunk Piston Engine Oils
Petromar XC 5540
Petromar XC 5040
Petromar XC 4040
Petromar XC 3000 Series
Petromar XC 2000 Series
Petromar XC 1500 Series
Petromar XC 1000 Series

Other Marine Lubricants
Petromar 65
Petromar HD Marine Series

GREASES

Regular Performance Greases
Petrogrease MP
Petrogrease XX

Premium Performance Greases
Molygrease EP2
Molygrease Premium
Petrogrease EP
Petrogrease Premium

High Temperature Greases
Molygrease EP IP and EP 2P
Petrogrease EP 290 and EP 375
Petrogrease HT

Complex Greases
Petrogrease Aluminum Complex
Petrogrease Lithium Complex with Moly

Food Grade Greases
Petrogrease Food Grade

ASPHALTS

Penetration Asphalt
Petropen

Cutback Asphalts
Petropen CB

Emulsified Asphalt
Petromul CSS -1

Blown Asphalts
Asphaltseal
Asphalt Joint Sealer

SPECIAL PRODUCTS

Process Oils
Process Oils
Product 50 R
Printsol 600
Rubbex 130
Stemol
Jute Batching Oil
Aldro Oil

Heat Transfer Oil
Petrotherm 32

Cleaning Agent
Greasolve

Solvents
Solvent 3040
Solvent 1425

Sealing Lubricant
Dust Stop Oil

Protective Coatings
Petrokote 500
Petrokote 392
Marinekote
Marinekote SS
Autokote
Cablelube
Cablekote

AFTERMARKET SPECIALTIES

Petromate Specialties
Petromate Oil Saver
Petromate Oil Improver
Petromate Gas Saver
Petromate Diesel Power Booster
Petromate Engine Flush
Petromate Super Coolant
Petromate Clean N' Shine
Petromate Penetrating Oil
Petromate Greaseaway
Petron Brake and Clutch Fluid

Others
Bull's Eye

AVIATION LUBRICANTS

Braycote 622
Nyco Grease GN 22
Hydraunycoil FH 51
Royco 481
Aviation Oil EE
Invarol FJ 13
Exxon Turbo Oil 2389
Exxon Turbo Oil 2380
Univis J-13
Turbonycoil 35 M

OTHERS

Naphtha
Reformate
Mixed Xylene

Information and Assistance

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Shareholder Services and Assistance
For questions or comments regarding dividend payments, change of address, account status, lost or damaged stock certificates, please get in touch with:

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Public Affairs Department
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Or with our stock transfer agent:

Stock Transfer Service, Inc.
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Annual reports, quarterly reports and other information on Petron can be downloaded from our internet website **www.petron.com**.

PETRON
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