2003 ANNUAL REPORT

"We Feel Good!"

Why We Feel Good

- > We registered a **₱3.1 billion** net income, **7%** higher than the previous year.
- > Market share in 2003 improved to **33.8%** from 33% in 2002.
- > Retail sales increased by **5.4%** outperforming all other players.
- > Export revenues increased by **32%** .
- > Aiming to be Best in Class by 2005, our Refinery achieved **95.5%** operational availability, much better than its targeted **92.9%.**
- > We have a new subsidiary called Petron Marketing Corporation that will bring in more income through **COCO (company-owned and company-operated)** stations.
- > International safety organizations gave several citations. Our Pandacan Terminal reached **2.5 million man-hours** without injury.
- > We were **chosen** to refuel Air Force One during President George W. Bush's state visit.
- > We were the **first** to come up with a nationwide SMS-based sales promo called "Tank Up 'N Text."
- > Our Ultron made **Walang Ganyan sa States** a famous tagline.
- > Our **fleet card** is the first and still the only one to have a microchip.
- > **925** Tulong Aral scholars completed their first year. **20** were awarded "First Honor."

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Mission Statement

We are a petroleum-based business enterprise in pursuit of growth and opportunities that are in the best interest of our shareholders.

We are committed to excellence in meeting customers' expectations and in caring for our community and environment.

We shall conduct ourselves with professionalism, integrity and fairness.

Company **Profile**

Petron Corporation is the largest oil refining and marketing company in the Philippines. Petron plays an integral role in national development. It supplies more than one-third of the country's oil requirements.

Its oil refinery, located in Limay, Bataan, is capable of producing 180,000 barrels per day. The ISO 9002-certified refinery processes crude oil that the company imports mostly from the Middle East into a full range of petroleum products, including LPG, gasoline, diesel, jet fuel, kerosene, industrial fuel oil, solvents and asphalts, as well as mixed xylene.

Petron moves the products mainly by sea from the refinery all the way to depots and terminals situated in key ports all over the country. Through this network, the company supplies fuel oil, diesel, and LPG needed to run the machines and engines of various industrial customers. The power sector is Petron's largest customer.

Petron also supplies jet fuel at key airports to airlines, including Philippine Airlines and other international and domestic carriers.

Through more than a thousand service stations, Petron retails gasoline, diesel and kerosene to motorists and public transport operators. Petron also sells its LPG brand Gasul to households and other consumers through an extensive dealership network. Customers can also purchase Gasul via the Tawag Lang Center, a dial-in ordering system.

Petron also operates a world-class lube oil blending plant at its terminal in Pandacan, Manila, where it manufactures Petron-branded lubes and greases. These are also sold through service stations and sales centers.

The company is gradually growing its non-fuel businesses such as "Treats," its own brand of convenience store and service station locators, including restaurants, coffee shops, and other consumer services. More of these will be found in several company-owned, company-operated (COCO) service stations which the company will put up soon.

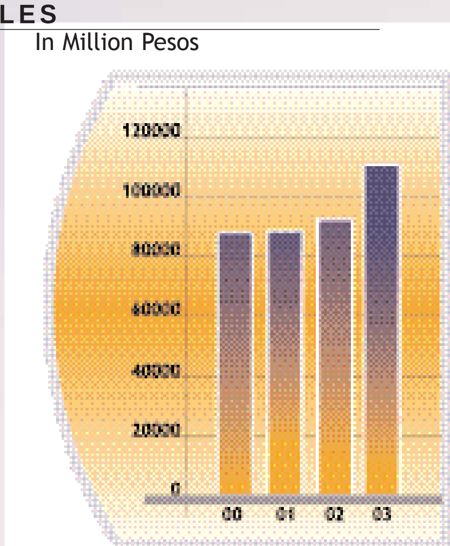
Petron is a publicly listed company, owned jointly by the Philippine National Oil Company and the Aramco Overseas Company, each having a 40% share of equity. A large base of close to 200,000 individual stockholders owns the remaining 20%.

Financial **Highlights**

	2003	2002	2001	2000
(In Million Pesos)				
SALES	**110,737**	92,330	88,427	87,968
NET INCOME (LOSS)	**3,108**	2,914	1,224	(2,549)
OPERATING EXPENSES	**3,522**	3,700	3,704	3,674
INCOME (LOSS) FROM OPERATIONS	**5,862**	5,162	3,499	(1,395)
PLANT, PROPERTY & EQUIPMENT	**21,497**	21,531	22,703	23,958
TOTAL ASSETS	**51,817**	50,576	50,868	53,491
TOTAL EQUITY	**20,072**	18,821	17,303	16,070
(In Pesos Per Share)				
EARNINGS PER SHARE	**0.33**	0.31	0.13	(0.27)
CASH DIVIDENDS DECLARED	**0.20**	0.15	–	–

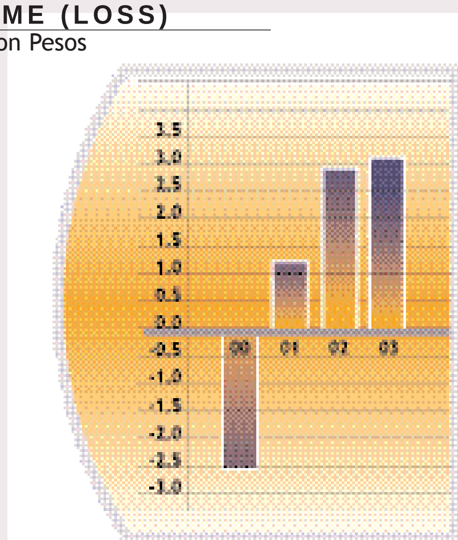
SALES

In Million Pesos



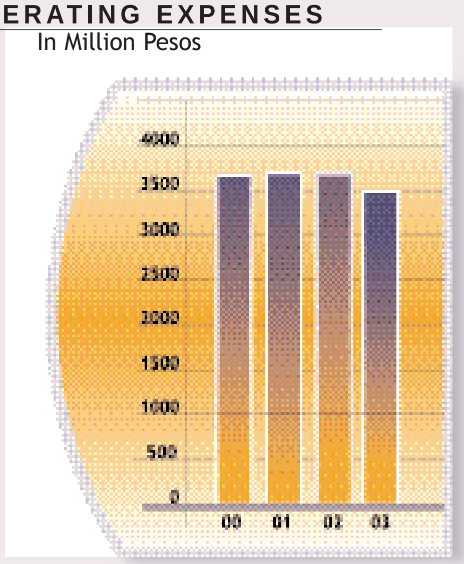
NET INCOME (LOSS)

In Billion Pesos



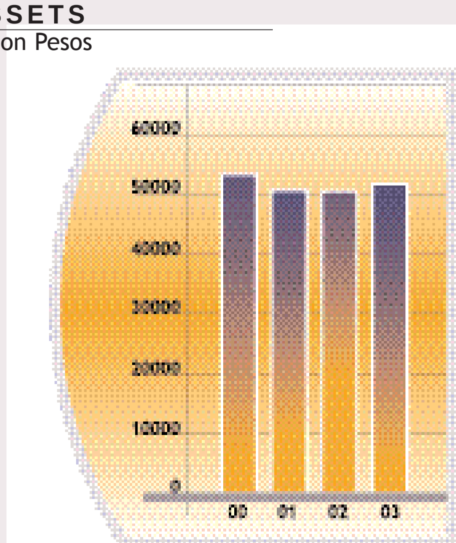
OPERATING EXPENSES

In Million Pesos



TOTAL ASSETS

In Million Pesos



NICASIO I. ALCANTARA chairman & chief executive officer

Message to **Our Stockholders**

DEAR STOCKHOLDER:

We have many reasons to feel good about our company.

OUR INCOME GREW, AGAIN.

2003 was our third consecutive year of earnings growth, following the loss we incurred in 2000. While the business environment remained fraught with uncertainty, Petron continued to pursue a steady course, driven by internal strengths as well as our unrelenting efforts to improve operating efficiency and customer service.

Thus, while the domestic oil market fell by 1%, Petron increased its local sales by almost 2% and accordingly raised its market share to nearly 34%, from 33% in 2002. Furthermore, we increased our exports to take advantage of favorable prices in the international market

Together with a reduction in operating expenses of about 5%, these achievements gave us an income of ₱3.1 billion in 2003 — higher by roughly 7% than our 2002 earnings.

WE DID BETTER THAN INDUSTRY.

Our improved performance can be considered remarkable in light of the events of the past year. The US-Iraq war and its aftermath brought higher and more volatile oil prices, which registered in higher fuel prices at the pump. The domestic economy was affected by the SARS scare and the Oakwood Mutiny. These events translated into sluggish oil demand locally.

KHALID D. AL-FADDAGH president

While the business environment remained fraught with uncertainty, Petron continued to pursue a steady course, driven by internal strengths as well as our unrelenting efforts to improve operating efficiency and customer service.

2003 was not auspicious for other players in the industry, and Petron alone among the refiners saw an increase in earnings. Late in the year, Caltex closed its refinery and opted to convert it to an import terminal. The new players, as aggressive as they are in certain markets, only managed to maintain the overall market share they had in 2002.

Petron saw its market share improve in most trades. Retail was our best performer, but our Industrial (non-NPC) and Lube trades also achieved higher market shares. In LPG, we remained the market leader, even as new players made significant inroads into this sector.

Our gains in the market came mainly from the efforts of our people, who have drawn upon a sense of mission to achieve their targets and win over competition. In addition, we invested in infrastructure to reach more customers and serve them better.

Our fleet and credit card programs have helped to generate more sales, and so have our promotions and ad campaigns (Walang Ganyan sa States!). Most significantly, the quality of our fuel and lube products is being increasingly recognized by discerning customers and car aficionados. Jaguar and other high-end vehicle manufacturers recommend our superior-performance gasoline, Blaze, to customers. And when President George W. Bush came to Manila for a state visit in October, our jet fuel was chosen for refueling Air Force One.

OUR SUPPLY CHAIN DELIVERED MORE VALUE.

Our performance in 2003 also owed much to higher efficiencies and value generated in our refinery, supply and operations activities.

The Petron Bataan Refinery (PBR) has launched a broad transformation program that, by 2005, should make it “Best in Class” in relation to its peers. The program is designed to result in more energy-efficient operations and improved product yields.

PBR surpassed most of its efficiency targets for the year and yielded a larger proportion of high-value white products per barrel of crude processed compared to 2002, helping to improve margins. Increased production of valuable mixed xylene also boosted our export revenues, which increased by 32%.

Higher export volumes at favorable prices helped to mitigate the increase in our supply costs as crude prices rose above 2002 levels. A significant increase in freight cost accompanied the hike in crude prices, but we managed to retain the distinction of having the lowest crude freight cost in the industry. We also improved the scheduling of crude liftings and arrivals, bringing crude tanker demurrage to its lowest in four years.

Our depot operations and product distribution activities likewise contributed to company cost savings — exploiting synergies with other companies. The most noteworthy of these is the Pandacan scale-down and joint venture project with Shell and Caltex, which is scheduled to start operations by mid-2004. The project, which will reduce our terminal costs by as much as 35%, is intended to satisfy safety or security concerns about the facility and contribute to urban development.

OUR CORPORATE CITIZENSHIP WAS RECOGNIZED.

Our health, safety, and environment (HSE) programs as well as those that support our corporate social responsibility (CSR) objectives won recognition from respected organizations.

For instance, Pandacan terminal was awarded a certificate of recognition by the World Safety Organization for reaching the milestone of 2.5 million man-hours without lost time injury. Our refinery also earned an upgraded safety rating from International Oil Insurers, resulting in a 20% reduction in our insurance premiums.

Meanwhile, UNICEF has chosen to team up with us, through Petron Foundation (PFI), in an unprecedented partnership in the industry that aims to promote child safety via an information campaign that makes use of our nationwide network of service stations.

Our program to help put children from needy families to school also brought satisfying results, as more than 12% of the first batch of 1,000 scholars topped their respective classes.

In integrated coastal management, which remains our primary vehicle for environmental care, Petron continues to take a lead role in Bataan. PFI heads the Bataan Coastal Care Foundation, which has been chosen by UNDP as its institutional partner in the pilot program for the coastal zoning of Manila Bay.

To highlight our commitment to the environment, we celebrated Petron’s 70th anniversary by conducting coastal or river clean-up and tree-planting operations in Bataan as well as in many of our depots.

OUR PROSPECTS ARE BRIGHT.

We are laying the foundation for Petron's continued leadership in the industry and the sustained profitability of our business.

In 2003, we started construction of two major projects at our refinery which will enable us to produce gasoline and diesel that comply with the Philippine Clean Air Act (CAA). By early 2005, we shall be relying on our own production of these fuels to supply our market, rather than depending on product imports like the rest of the industry. This has strong positive implications for us in terms of supply security or dependability, as well as consistent product quality. For CAA-compliant gasoline, in particular, Petron will have a unique production capability that should give us an edge over all of our competitors.

On the marketing side, we have embarked on a program to put up company-owned-company-operated (COCO) service stations in strategic locations to avail of the opportunities presented by the recently passed Retail Trade Liberalization Act. Aimed at bringing in additional revenue streams, COCO stations will rise in high-traffic, high-visibility sites. This program also draws on the success of existing convenience stores and food outlets in some of our stations. In 2003, revenues from our non-fuel business grew by 18%.

We have set up a new subsidiary called the Petron Marketing Corporation to oversee the establishment and management of 30 COCO service stations in strategic areas over five years. Another subsidiary named Petron Treats Subic, Inc. was established to operate our "mega-station" at the Subic Bay Metropolitan Area (SBMA). The 3,200 square meter service station is expected to be operational by the middle of 2004.

These initiatives, together with our continuing drive for operational excellence and stronger customer focus, promise to secure our growth and leadership position into the future. While we foresee that the business environment will continue to present challenges, and that competition in the industry will remain vigorous, we are sure of our path, and that is forward and upward!

With your continued trust and support in Petron, we are confident that we will be able to sustain the progress we have made.

We feel good, and we hope you do too!

NICASIO I. ALCANTARA
Chairman & Chief Executive Officer

KHALID D. AL-FADDAGH
President

The new Petron COCO station at EDSA-Dasmariñas Village

Innovative Services

The year in Review

MARKETING

Petron's sales grew in a tighter market.

Despite a contraction in local oil demand of 1.0%, Petron's domestic sales of fuels and lubes increased nearly 2% to reach close to 40 million barrels. The company's share of the total market, including new players, accordingly improved to 33.8% from 33% in 2002, affirming its market leadership.

Our sales growth in most trades was better than industry. Outside the power sector, the market fell by 1.5%, but Petron nevertheless saw its volumes grow by 2.6%.

Retail had the best story.

Our sales to the highly competitive Retail market increased by 5.4%, outperforming all other players as total demand in this sector grew less than 1%. This gave us an increase in Retail market share of 1.5 percentage points, bringing this to 32.3%, and closed our gap with the traditional leader in this market to 1.3% from 2.8% in 2002.

Retail is the largest segment of the market, and accounts for more than half of fuel sales outside the power sector. Petron serves this market through its service stations, with a share of about 30% of total industry outlet count. In 2003, 30 new stations were added to the company's network, bringing total outlet count to 1,159.

A strong Retail infrastructure has been key to our success in growing our share of this important market, but complementing this and equally important were the determined efforts of our sales people as well as effective promotions and advertisements.

For example, to boost sales and generate a customer database, we had a nationwide SMS-based promo dubbed "Tank Up N' Text", the first of its kind in the industry. It ran from August to November 2003, and generated over two million entries from 143,000 mobile phone subscribers.

Other activities of note include Petron's participation in the Department of Energy's (DOE) diesel discounting program for the transport sector that started September 2003. We also led in the launch of 0.05% sulfur diesel, ahead of even the accelerated implementation date of November 2003 set by DOE for Metro Manila.

Of greater long-term import, however, is the company's

Our sales growth in most trades was better than industry. Outside the power sector, Petron saw its volumes grow by 2.6%.

(Starting from top, counter-clockwise) **Housewives have the convenience of calling the Gasul Tawag Lang Center Hotline 532-2222. Diesel discounts were offered to the transport sector at selected Metro Manila service stations. The Ultron tagline "Walang Ganyan sa States" became a big hit. Several existing customers continued to rely on Petron's reliability and after-sales service.**

continued development of non-fuel businesses in key locations to attract more motorists. Over the past few years, Petron has introduced convenience stores, called "Treats," and arranged the establishment of quick-serve restaurants and other locators in selected locations.

The success of these non-fuel businesses has inspired the company to take the idea forward. With the passage of the Retail Trade Liberalization Act, Petron can now operate its own stations and other retail or service enterprises therein. A COCO (company-owned, company-operated) program aims to set up several sites under a separately incorporated subsidiary called the Petron Marketing Corporation.

At the end of 2003, Petron had 32 "Treats" stores — an addition of 10 to the 2002 figure — and 27 locators. They generated a combined revenue of ₱46 million, up by 18% from the previous year.

Industrial sales grew despite falling demand.

Sluggish business activity during the year was reflected in a drop of over 6% in fuel demand from industrial customers (excluding the National Power Corporation or NPC). Petron, however, still managed to grow its sales to this sector by 0.4%.

We won new major accounts — such as the country's largest independent power producer — and renewed supply contracts with several existing customers on the strength of Petron's supply reliability and superior after-sales service.

An interesting development that highlighted the world-class quality of Petron's products, services, and facilities, was the choice of the company by the US Presidential Advance Team Agents and the dedicated US Quality Assurance specialist to refuel Air Force One — the official aircraft of the U.S. President — during the state visit of President George W. Bush in October.

Meanwhile, our sales to NPC continued to make up a good portion of our volumes. They accounted for about 12% of Marketing sales, only slightly lower than the year before. Petron continued to be the leading fuel supplier of NPC, with 58.9% share of its purchases.

Petron Gasul still leads in a hotly contested market.

The LPG market has been one of the easiest points of entry for new

players in the local market, since domestic production has always been short of demand, and distribution to households has been facilitated by the existence of numerous neighborhood retail outlets. Thus, half a decade after deregulation, new players as a group now dominate the sector, accounting for about 38% of industry sales in 2003.

Nevertheless, among the known brands, Petron Gasul continues to be the most preferred by Filipino consumers. In 2003, Petron remained the market leader and actually gained 1.2% market share relative to the other majors. This was partly due to the acquisition of new fastfood and other commercial accounts.

Petron has endeavored to safeguard the interests of LPG consumers and protect its brand by means of information campaigns to help consumers distinguish between genuine and fake Gasul tanks. In cooperation with other key players in the industry, Petron continues to work to curb illegal and unsafe LPG practices.

Petron was chosen to refuel Air Force One, the official airplane of US President George W. Bush during his state visit in October.

Part of our defense against the encroachment of illegal re-fillers on our market is the strengthening of our Gasul dealer network, which consisted of 182 dealerships at the end of 2003. We also conducted a contest to motivate our dealers to achieve sales targets.

Petron was lone performer in lackluster Lube trade.

Petron's share of the lubricants market is modest at around 28.8%, but in 2003 it was the only one among the majors that saw a growth in sales. The majors as a group lost over 6% in volumes, but Petron's lube sales increased almost 2%.

Banner products such as Ultron, Rev-X, and 2T were mainly responsible for the improvement. The re-launch of Ultron, our automotive gasoline engine oil, memorable for the famous advertising tagline, "Walang Ganyan sa States," quickly captured the attention of consumers.

To meet the different needs of motorists, Ultron comes in four variants, namely: Race, Rallye, Touring, and Extra. Petron's popular motorcycle engine oils, 2T Powerburn and 2T Autolube, were also launched in late 2003 using tri-media advertising — the first in the industry.

At the end of 2003, Petron had 27 Petron Sales Centers distributing specialty products and lubricants to service stations, auto shops, and car dealers.

Expert technical and marketing services supported the success of the trades.

High-quality products and technical services have always been a trademark of Petron. This is made possible by our high-caliber Technical Services people, who continually seek to enhance the quality and performance of our fuels and lubes. In 2003, this group developed new products, including a 4T oil for four-stroke motorcycles, 2T low-smoke oil, Petromar XC 5040, and the Petron Tire Black. They also enhanced the quality and performance levels of existing products including LS DieselMax, Rev-X Trekker, 2T Powerburn, and 2T Autolube.

Similarly, our Marketing Services group continued to conceive and implement programs designed to enhance the effectiveness of our sales efforts. These include our Cards program, covering the Petron Fleet Card and the Petron BPI–Mastercard. The Petron Fleet Card, which was soft-launched in mid-2003, is the first and only one of its kind equipped with a microchip, which makes monitoring and controlling fleet expenses more convenient.

Marketing Services also spearheaded initiatives for a customer-focused culture, drawing up a Petron Call Center Master Plan and administering a program that seeks to define and increase customer awareness.

Likewise, advertising and sponsorships were designed to strengthen brand recall and patronage. Sponsorships included sports

We continued to conceive and implement programs designed to enhance the effectiveness of our sales efforts. It also spearheaded initiatives for a customer-focused culture.

(*Left to right*) **The Petron Fleet Card's unique microchip has features that fit the needs of our customers. Enhanced 2T engine oil gives better performance to tricycle engines. Another industry first is the SMS-based promo "Tank Up 'N Text."**

— notably Philippine Taekwondo — and concerts of noted local and foreign artists such as Sergio Mendes, Lani Misalucha, and Mariah Carey, among others.

Also worth noting is the third of the ArtPetron series of painting competitions for young Filipino artists. Subtitled "Lumang Tanawin, Bagong Likhain," ArtPetron 3 focused on Philippine landscapes. As a promotional and image-building activity, ArtPetron has been recognized repeatedly by respected PR organizations.

REFINERY

Aiming to be Best in Class in 2005

Deregulation and the free entry of refined products into the country has had consequences not only for our Marketing business but all the way up the supply chain. To remain competitive, a domestic refiner like Petron needs to match the efficiency of refineries abroad.

Thus, our Bataan refinery has embarked on a set of programs and projects generally designed to bring it to Best in Class status in 2005. Ultimately, this means higher refinery utilization, more energy-efficient operations, lower operating costs, and improved product yields — not to mention stronger morale and productivity of our workforce.

The programs are a mix of initiatives drawing on opportunities for technical or mechanical improvements in operations, better planning, control and monitoring practices, and encouraging a culture of continuous improvement among the employees.

Major projects being implemented include an LVN Isomerization Unit and a Gasoil Hydrotreater, which will enable Petron to produce gasoline and diesel, respectively, that comply with the Philippine Clean Air Act (CAA). We are also implementing Offsites Automation and Energy Efficiency projects, both intended to lead to significant energy savings. All of these projects will be operational by early 2005, and part of our preparations is a comprehensive technical training program for our refinery workforce to prepare them for the changes these projects will bring in terms of operational complexity.

2003 results indicate we are on track.

In 2003, our refinery surpassed most of its efficiency targets, including unit manufacturing cost, processing efficiency, operational

Vice President Al Trio leads his team in making the refinery Best in Class by 2005.

availability, maintenance index, and energy intensity index. Apart from lower-than-projected operating expenses, the impact of these accomplishments was seen in improved white (high-value) product recovery, particularly for Mixed Xylene, LPG, diesel, and gasoline. The incremental output of these products resulting from our efficiency improvement programs was worth roughly ₱280 million.

Refinery operations continued to adhere to environmental standards and regulations set by law, consistently passing emission and effluent standards of the Department of Environment and Natural Resources. Furthermore, we engaged the services of Neville Clarke Phils. for the development, design, and implementation of an Environmental Management System in accordance with ISO 14001, with the target date for certification set for September 2004.

In terms of safety, the refinery registered a higher rating with the International Oil Insurer, resulting in a reduction of insurance premiums of about ₱56 million.

SUPPLY AND OPERATIONS

Export volumes and revenues grew.

Exports accounted for about 17% of Petron's total sales in 2003. Sales to this market increased by about 3% to roughly 8.5 million barrels. Although the growth in volumes was modest, export revenues increased by ₱3.5 billion or 32% over the 2002 level.

The increase in export revenues was driven by higher exports of Mixed Xylene, which grew by 31%. Selling prices of the product also surged in 2003, averaging about US$440.00 per metric ton versus about US$320.00/MT the previous year, or an increase of about 38%. In addition, our term exports of straight-run fuel oil (SRFO) fetched a significantly higher premium compared to 2002. Likewise, naphtha export prices were also much better compared to the previous year.

Supply costs higher but compared favorably with benchmarks.

The industry saw significantly higher costs in 2003, with crude prices (Dubai) rising by 12% to US$26.76 from an average of US$23.85 per barrel in 2002. Crude freight costs, however, increased at an even faster rate, reaching nearly double the 2002 level. This was due to tight tonnage in the international

Our gains came mainly from the efforts of our people, who have drawn upon a sense of mission to achieve their targets.

(Starting from top, counter-clockwise) **Vice President for Marketing Joey Campos meets with his team of Marketing Services and Direct Retail managers. A strong retail infrastructure, together with the determined efforts of our sales people like our marketing executives, is key to our growing success in this market. Safety training including the use of the fire-fighting equipment is given to employees.**

tanker market as a result of the implementation of the double-hull requirement for vessels.

As in 2002, Petron had the lowest crude freight cost per barrel in the industry. This was about 13% lower than competition and was the product of skillful negotiations by our Supply people. We consistently chartered vessels below market assessment, and the discount to market that we achieved in 2003 was the highest in five years.

It is also worth mentioning that we reduced the incidence of crude tanker demurrage through improved scheduling of crude liftings and arrivals, which brought excess laytime to the lowest in four years.

Continued the drive to implement cost-effective solutions.

We continued to seek improved efficiencies through synergies with other companies, the most recent of which is in LPG supply and distribution, with two other oil players.

Project SHAPE — the joint use of our Mandaue depot with another company which started in 2002 — has become a model for two-party cooperation in the industry. In 2003, the arrangement generated rental income for Petron amounting to more than ₱25 million and savings worth ₱18 million.

Economies are similarly expected from the Pandacan Scale-down Project, which involves the integration of product storage and support systems of Petron, Shell, and Caltex, and the creation of a joint venture company to operate the terminal for the three oil companies. Tank dismantling operations neared completion by the end of 2003, and the Petron Linear Park — a buffer zone — was completed. The start of joint operations, which is expected to result in a reduction in terminal costs of up to 35%, is scheduled for mid-2004.

Another cost-effective solution was the addition of LPG tankage in our Davao depot. This has enabled Petron to supply its market in the south by importing LPG directly from nearby suppliers rather than sourcing from Batangas or Limay, thereby reducing transshipment costs significantly.

It is also worth noting that safety records achieved in Pandacan (10 years without lost time injury as of December 26, 2003) contributed to cost savings for the company by supporting a favorable rating by insurers.

BUSINESS SYSTEMS AND TECHNOLOGY

IT remained a major tool for streamlining company operations.

Petron’s IT strategy consists of a five-point program that is anchored

Petron continued to explore and use IT solutions to generate real-time management information on the business.

on business process re-engineering and automation.

Essentially, the company has continued to explore and use IT solutions to enhance transaction processing capability, improve access to customers and vendors, facilitate the exchange of information within the company, and generate real-time management information on the business. We are also looking at IT as a means of directly adding value to our products and services.

In 2003, Petron implemented a Corporate Finance Management (CFM) module that was integrated with the accounting, sales, and purchasing modules of SAP. CFM also made use of the SAP Market Risk Management (MRM) module — the first implementation of this kind in the Asia-Pacific region. MRM provides reports on currency/ interest exposure, cash flow analysis, and value-at-risk analysis.

We collaborated with IT partners to expand the reach of the company geographically via the web and mobile computing technology, exploring vertical integration of processes through business-to-business (B2B) initiatives with vendors and customers.

We expanded the application of our Business Information Warehouse to include analysis of profitability by strategic business unit, the return on assets at service stations, and aging of trade accounts receivables.

Petron worked for consistent optimization of IT resources through consolidation and creative uses of technology. For example, the switch from leased line to frame relay network technology has reduced the cost of corporate telecommunications by more than 50% while maintaining a more robust network architecture. Security has also been strengthened in order to safeguard the IT investments of the company through encryption and installation of additional security systems.

HUMAN RESOURCES AND PEOPLE DEVELOPMENT

Aiming to become the "Employer of Choice."

Our people strategy focused on competency enhancement, maintaining harmony in the workplace, and creating a balanced work-life.

To enhance competencies of over 1,200 employees, in-house training programs emphasized business-mindedness, technical skills, and customer interfaces. We also organized learning sessions that featured success stories of renowned "champions" such as world-class educator Dr. Josephine Biyo. The stories of strategic leadership, customer relations management, corporate social responsibility, and commitment to excellence, were meant to inspire our employees to rise above the challenges of the uncertain environment.

To maintain a healthy work climate, we conducted team-building workshops, fellowship sessions, as well as labor management relations workshops. We updated our Code of Conduct and Ethical Business Policy and Company Rules and Regulations and distributed copies of these to all employees to highlight the importance of good governance.

We were given recognition for maintaining harmonious relationships between management and the three company unions that represent our rank-and-file employees when the company was named among the finalists for the Employers’ Confederation of the Philippines Gawad Kapatid Award.

In support of balanced work-life, Petron created venues for the creative release of stress through recreational and sports activities by tapping the assistance of different sports clubs. "Brown Bag" sessions on topics as diverse as Stress Management, Financial Freedom, Zen Gardening and Ikebana, Beadmaking, and Cooking were regularly conducted.

Our people strategy focused on competency enhancement, maintaining harmony in the workplace, and creating a balanced work-life.

(Starting from top counter-clockwise) **The success story of renowned educator, Dr. Josephine Biyo, was featured in An Hour With the Champion. Venues for creative release of stress include the various sports activities and brown bag sessions such as this one for a beadmaking class. The harmonious relationships between management and its three unions earned for the company the distinction of being a finalist to the Gawad Kapatid Award.**

HEALTH, SAFETY AND ENVIRONMENT

Continued commitment to the highest standards.

Our health, safety and environment (HSE) programs were rewarded with citations from international safety organizations.

Our Pandacan Terminal was awarded a certificate of recognition by the World Safety Organization for achieving 2.5 million man-hours without lost time injury. The terminal was also rated "world-class" in terms of safety commitment, culture, and housekeeping by the International Oil Insurer during an audit held in September 2003. Likewise, the Rosario Terminal achieved a safety milestone after reaching 500,000 man-hours of being injury-free.

The company's aviation facilities and Into-Plane Operations were also declared to be consistent with international standards by the Joint Inspection Group, another prominent internationally recognized safety organization. We got further affirmation on this when Petron was chosen to refuel Air Force One during US President George W. Bush's visit to Manila in October.

We continued to conduct regular safety assessments and reviews at our refinery, major installations, and several depots. As recommended by Du Pont, several training sessions on basic safety, first aid, and basic life support were conducted for employees and contractors. Vessel safety training sessions were also carried out, and pollution-control training seminars were held for regular and contractual operations personnel as well as service station staff and dealers.

To further enhance safety and efficiency in the depots, new fire-fighting equipment and waste management facilities were installed. Fire-fighting Olympics and fire drill activities were also held in the terminals, depots, and service stations to strengthen fire contingency measures. Joint spill exercises were held to reinforce emergency preparedness in cases of oil spill incidents.

Petron also stressed the importance of corporate wellness. On top of regular health examinations that ensure the physical fitness of current employees, health-related activities such as the SARS Awareness and Prevention Program, Blood Donation Program and free cholesterol and

Corporate Citizenship

A storage tank donned with colorful images of endangered animals brings life to the Petron Pandacan Linear Park.

optical and dental check-ups were conducted. Fitness programs such as aerobics and regular workouts at the gym continued.

Petron publishes a separate report which details all of its HSE programs.

CORPORATE SOCIAL RESPONSIBILITY

We deepened our commitment to education, environment, and health programs.

September 2003 marked the 70th anniversary of our company, and we chose to celebrate this by conducting a set of activities that highlighted our commitment to corporate social responsibility or CSR. At our Bataan refinery and many of our terminals and depots around the country, our employees participated in coastal or river clean-up as well as tree or mangrove planting. We also had book-giving drives in some locations, distributing some 1,700 packs of educational books and magazines mainly for children of public utility drivers.

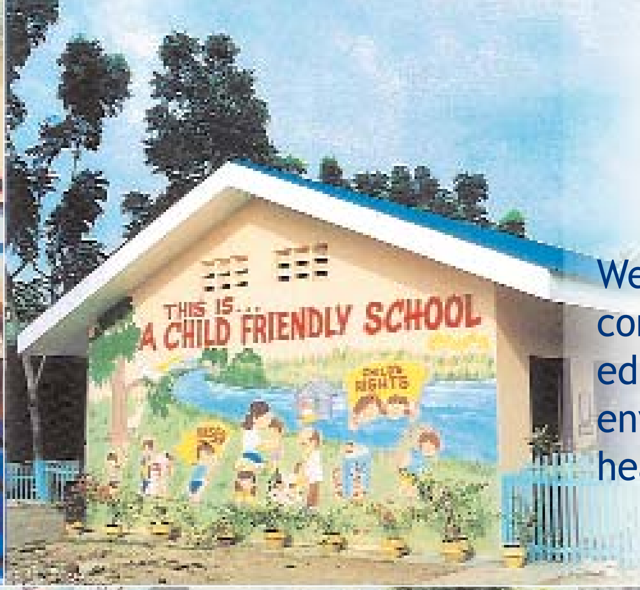
Through Petron Foundation, we continued to strengthen our regular CSR programs and actively sought avenues for increasing their effectiveness.

In March 2003, our banner program in education, Tulong Aral, completed the first year of its implementation with resounding success. Out of 1,000 scholars, 925 completed the full school year, with 123 excelling in their studies. Twenty of the children were awarded "First Honor" in their respective classes.

Tulong Aral received formal recognition by the Department of Education, when they signed a Memorandum of Agreement with Petron. Furthermore, we are helping to institutionalize the concept by developing a Tulong Aral operations manual and a database. We have also drawn up support programs for the scholars including tutorial lessons, supplemental feeding, field trips, and livelihood training for the parents.

Still part of our thrust in education, we built two new Petron Schools in Mindanao, benefiting schoolchildren in impoverished areas.

We also forged a partnership with the United Nations Children's Emergency Fund or UNICEF and our dealers' association (PETDA), which aims to raise the level of safety consciousness, particularly for children. Dubbed "Petron for Kids," the program will take advantage of our network of service stations to



We deepened our commitment to education, environment and health programs.

(Starting from top, counter-clockwise) **One of two Petron schools opened in Mindanao will benefit impoverished children. Tulong Aral scholars get a special Christmas treat during the Project JOY at Malacañang. A tricycle driver's daughter receives with delight book donation from Chairman Alcantara.**

promote child safety and will eventually involve government agencies, academic institutions, and transport groups as partners.

With regard to the environment, our primary vehicle remains the integrated coastal management program for Bataan — known as Bigkis-Bataan. Petron Foundation has been the main driving force in the program's development and implementation, through its leadership role in the Bataan Coastal Care Foundation (BCCF). The program involves providing assistance to fisherfolk in setting up supplemental livelihood activities, as well as the development of a coastal zoning and sea-use plan. The United Nations Development Programme (UNDP) has proposed to make Bataan its pilot site for the coastal zoning of Manila Bay, with BCCF as the channel for funding.

In the meantime, our regular province-wide Kontra Kalat sa Dagat coastal clean-up drive and mangrove enrichment planting continued. Some 15,330 volunteers — our employees and other stakeholders — participated in 2003, relieving the coasts of more than 214 metric tons of garbage, and planting a total of 90,600 mangrove propagules.

With regard to our health and human services programs, we conducted Lakbayanihan medical missions in indigent communities in Pandacan and Navotas. Some 4,760 patients were given free medical and dental treatment, as well as free medicines. We had volunteers numbering 1,769 — including doctors, nurses, and Petron employees and service personnel.

Towards the end of the year, we held the seventh of our series of Project JOY, distributing gifts to children from poor families. The event was held in coordination with the Department of Social Welfare and Development and the Department of Education.

Employee volunteerism remained the cornerstone of our CSR practice. This inspired the publication of a book co-authored by Petron Foundation and co-published by the Philippine Business for Social Progress. Titled "Linking Worlds," the book provides a practical guide to developing a strategic and sustainable corporate volunteering program.

Details of Petron Foundation's programs and activities may be viewed from its website, and are also published in a yearly achievement report.

Board of **Directors**

Nicasio I. Alcantara
(61 years old)
Chairman and Chief Executive Officer
He is presently a Director of Bancasia Finance & Service Corporation, United Pulp & Paper Corporation, Philodrill Corporation and Bank One Savings & Trust Corporation.

Khalid D. Al-Faddagh
(48 years old)
President
In his more than 20 years in the oil industry, he has held various professional and management positions in Saudi Aramco, the most recent of which is as Manager of Facilities Planning Department.

Motassim A. Al-Ma'ashouq
(42 years old)
Non-Executive Director
He has served as President and Chief Executive Officer of the Company from September 2000 to July 2002. He also served as Vice President for the Company from 1996–1999.

Bernardino R. Abes
(73 years old)
Non-Executive Director
He is the Chairman of the Social Security Commission and was until recently Presidential Adviser on Legislative Affairs and Head of the Presidential Legislative Liaison Office.

Ziyad M. Al-Shiha
(37 years old)
Executive Director
He was Manager of Saudi Aramco's Uthmaniyah Gas Plant, one of the largest gas plants in the world. In his 18 years with Saudi Aramco, he covered a number of challenging assignments in various areas of operations.

Bob D. Gothong
(48 years old)
Non-executive Director
He is currently the Vice Chairman of Aboitiz Transportation System, Chairman/CEO of Gothong Southern, Inc., and Vice Chairman of Carlos A. Gothong Holdings, Inc.

Khalid G. Al-Buainain
(45 years old)
Non-executive Director
He is currently the Vice President for Refining of Saudi Aramco. He has held several management positions in various areas including Medical Services, Marketing, and Terminal Operations.

Francisco L. Viray
(55 years old)
Non-executive Director
He is currently President of Trans-Asia Power Generation Corporation. He served as the Secretary of the Department of Energy from 1994–1998, and he also served as the Chairman of the Board of the National Power Corporation and the Philippine National Oil Company.

Jose Luis U. Yulo, Jr.
(56 years old)
Independent Director
He is currently the Chairman/CEO of Insurance of the Philippine Islands, Inc., and Philippine Exhibits and Theme Parks Corporation. He is also the President/CEO of One Card International Co., Inc. ("Mastercard") and Centrex Corporation/Octanorm Philippines.

Douhan H. Al-Douhan
(68 years old)
Independent Director
He is a retired Executive Director of Saudi Aramco's Management Services Organization. He also held several management positions in various departments of Saudi Aramco.


NICASIO I. ALCANTARA


KHALID D. AL-FADDAGH


WALTER A. TAN


JOSE K. CAMPOS, JR.

Management Committee and **Executive Officers***

Nicasio I. Alcantara
Chairman and
Chief Executive Officer

Khalid D. Al-Faddagh
President

Walter A. Tan
Vice President for Supply
and Operations

Jose K. Campos, Jr.
Vice President for Marketing

Alfred A. Trio
Vice President for Refinery

Ziyad M. Al-Shiha
Vice President for Corporate Planning

Antonio G. Pelayo
Vice President for Finance and
Subsidiaries and Controller

Rosario R. Eijansantos
Treasurer

Luis A. Maglaya
Corporate Secretary

*as of December 31, 2003


ALFRED A. TRIO ZIYAD M. AL-SHIHA ANTONIO G. PELAYO ROSARIO R. EIJANSANTOS LUIS A. MAGLAYA

Petron's **Legacy**

1933 Merger of Standard Oil Company of New Jersey and Socony Mobil Oil into Standard Vacuum Oil Company (Stanvac), established in Delaware, USA, on September 7.

1945 After World War II, Stanvac reopens for business in April. Reconstruction of storage tanks begin.

1958 New Stanvac office in Cebu is inaugurated on May 29.

1961 Bataan Refinery is inaugurated on April 8 with a refining capacity of 25,000 barrels per day.

1962 Stanvac splits into Mobil Oil Co., Inc. and Esso Standard Eastern, Inc. Esso would take over the marketing business in Luzon and Mobil in the Visayas and Mindanao.

1973 PNOC (Philippine National Oil Company) acquires Esso Phils., Inc. from Esso. The company was renamed Petrophil. PNOC increased its shares in the Bataan Refining Corporation from 57 percent to 60 percent, purchasing 3 percent of Mobil's stock.

1983 Mobil divests its interest in the Bataan Refinery. PNOC becomes its full owner.

1993 PNOC successfully bids out 40 percent equity in Petron on December 15; Saudi Aramco submits best bid.

1994 Petron lists its shares on September 7 under trading symbol "PCOR."

1997 Petron launches its new image and new logo, beginning with Mercedes service station in Pasig.

1998 Treats, its 24-hour convenience store, is launched.

Report of Independent **Public Accountants**

SGV &

SyCip Gorres Velayo & Co.
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1226 Makati City

Philippines
Phone: (632) 891-0307
Fax: (632) 819-0872
www.sgv.com.ph

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, 2003 and 2002, 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, 2003. 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, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with the accounting principles generally accepted in the Philippines.

SyCip Gorres Velayo & Co.

PTR No. 7012889
January 5, 2004
Makati City

March 24, 2004

Consolidated **Statements of Income**

(AMOUNTS IN MILLIONS, EXCEPT PER SHARE AMOUNTS)

	Years Ended December 31		
	2003	2002	2001
SALES (Notes 20 and 25)	**₱ 110,737**	₱ 92,330	₱ 88,427
COST OF GOODS SOLD			
(Notes 6, 16, 18, 20, and 23)	**101,353**	83,468	81,224
GROSS PROFIT	**9,384**	8,862	7,203
OPERATING EXPENSES (Notes 17 and 18)	**3,522**	3,700	3,704
INCOME FROM OPERATIONS	**5,862**	5,162	3,499
OTHER CHARGES - Net			
Interest (Notes 10, 12 and 17)	**(1,258)**	(811)	(1,408)
Foreign exchange gain (loss) (Note 23)	**(16)**	(200)	112
Miscellaneous	**(478)**	(6)	(319)
	(1,752)	(1,017)	(1,615)
INCOME BEFORE INCOME TAX	**4,110**	4,145	1,884
PROVISION FOR INCOME TAX			
(Notes 15 and 24)			
Current	**782**	262	196
Deferred	**220**	969	464
	1,002	1,231	660
NET INCOME (Note 21)	**₱ 3,108**	₱ 2,914	₱ 1,224
EARNINGS PER SHARE			
(Note 21)	**₱ 0.33**	₱ 0.31	₱ 0.13

See accompanying Notes to Consolidated Financial Statements.

Mixed Xylene Operation **Statements of Income**

(AMOUNTS IN MILLIONS, EXCEPT SALES VOLUME)

	Years Ended December 31	
	2003	2002
SALES	**₱ 2,418**	₱ 1,275
COST OF GOODS SOLD	**1,519**	908
NET INCOME	**₱ 899**	₱ 367
Sales Volume (in barrels)	**742,920**	565,140

Consolidated **Statements of Cash Flows**

(AMOUNTS IN MILLIONS)

	Years Ended December 31		
	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱ 4,110**	₱ 4,145	₱ 1,884
Adjustments for:			
Depreciation and amortization	**2,114**	2,284	2,330
Interest expense	**1,493**	1,068	1,823
Interest income	**(235)**	(257)	(415)
Cylinder deposits written-on	**(224)**	–	–
Provision for (reversal of allowance for) market decline of current marketable equity securities	**(12)**	(5)	18
Unrealized foreign exchange loss	**33**	184	40
Operating income before working capital changes	**7,279**	7,419	5,680
Changes in operating assets and liabilities (Note 22)	**(2,764)**	(113)	(4,386)
Interest paid	**(1,484)**	(1,084)	(1,882)
Income tax paid	**(353)**	(284)	(196)
Interest received	**244**	254	427
Net cash provided by (used in) operating activities	**2,922**	6,192	(357)
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to property, plant and equipment	**(1,646)**	(1,106)	(867)
Decrease (increase) in:			
Receivables - others	**504**	54	763
Other noncurrent assets	**(43)**	29	(29)
Reductions from (additions to) investments	**(367)**	300	(32)
Acquisition of a subsidiary, net of cash acquired (Note 22)	**(209)**	–	–
Net cash used in investing activities	**(1,761)**	(723)	(165)
CASH FLOWS FROM FINANCING ACTIVITIES			
Payments of:			
Loans	**(29,491)**	(39,855)	(53,477)
Cash dividends	**(1,829)**	(1,380)	–
Availments of loans	**27,447**	36,647	51,428
Cylinder deposits received and others	**121**	99	76
Minority interest	**7**	10	17
Net cash used in financing activities	**(3,745)**	(4,479)	(1,956)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(₱32)**	(₱10)	₱ 10
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**(2,616)**	980	(2,468)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**5,419**	4,439	6,907
CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 3)	**₱ 2,803**	₱ 5,419	₱ 4,439

See accompanying Notes to Consolidated Financial Statements.

Minority interest in the net income of NVRC, which is not material, is included under "Other charges" 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.

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 with a charge to current operations. 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 first in-first out (FIFO) method in costing crude oil and other products and the last in-first out (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 recorded as part of this account. 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 comprises its purchase price, including import duties and taxes and any directly attributable costs of bringing the assets to their working condition and location for their 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 acquisition and/or construction of the projects. Expenditures incurred after the property, plant and equipment have been put into operation, such as repairs and 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 an additional cost 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 of property, plant and equipment 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, 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 expense 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 assets is the greater of net selling price and value in use. 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 fair value of identifiable net assets 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.

Negative goodwill is the excess of the Company's interest in the fair value of a subsidiary's net 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.

Starting 2003, 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.

6. Inventories

	2003	2002
At cost		
Petroleum	**₱ 6,493**	₱ 5,378
Crude oil and others	**8,485**	5,215
At net realizable value		
TBA products, materials and supplies	**696**	884
	₱ 15,674	₱ 11,477

Using the moving average method, the cost of petroleum products would have increased by ₱2,081 as of December 31, 2003 and ₱2,111 as of December 31, 2002.

7. Investments

	2003	2002
Notes and bonds - at amortized cost	**₱ 668**	₱ 284
Shares of stock - at cost	**71**	156
Other investments (net of allowance for decline in value of ₱476 in 2002)	**118**	118
	₱ 857	₱ 558

On January 27, 2004, the Securities and Exchange Commission issued the Certificate of Incorporation of Petron Marketing Corporation (PMC), a subsidiary established by Petron. PMC will operate 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 Petron the opportunity to quickly introduce innovations beyond the present services that are available in Petron stations. Until recently, Petron, being partly foreign-owned, was not allowed by the Retail Trade Law to engage in direct retailing. Under the aegis of the Retail Trade Liberalization Act (RTLA), however, the Board of Investments has approved Petron's application to establish a retail enterprise, paving the way for the establishment of a direct-retailing subsidiary.

Other investments account includes Petron's matured investments with an institution under financial difficulty or receivership. This was written down to ₱104 in 2002 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.

8. Property, Plant and Equipment

Net carrying amount, at

	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, 2003	₱5,531	₱12,154	₱405	₱266	₱2,126	₱1,049	₱21,531
Additions*	–	–	–	–	560	1,504	2,064
Transfers	104	410	246	160	31	(951)	–
Depreciation and amortization charges for the year	(355)	(1,394)	(141)	(95)	(113)	–	(2,098)
Net carrying amount, at December 31, 2003	₱5,280	₱11,170	₱510	₱331	₱2,604	₱1,602	₱21,497
At January 1, 2003							
Cost	₱7,060	₱20,380	₱2,593	₱1,468	₱2,865	₱1,049	₱35,415
Accumulated depreciation and amortization	(1,529)	(8,226)	(2,188)	(1,202)	(739)	–	(13,884)
Net carrying amount	₱5,531	₱12,154	₱405	₱266	₱2,126	₱1,049	₱21,531
At December 31, 2003							
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

*Additions include assets of newly acquired subsidiary (see Note 9).

Cumulative capitalized foreign exchange losses, net of depreciation, amounted to ₱2,411 as of December 31, 2003 and ₱2,640 as of December 31, 2002. No foreign exchange adjustment was capitalized in 2003 and 2002. Interest capitalized in 2003 amounted to ₱24 using a capitalization rate of 6.58%. No interest was capitalized in 2002.

9. 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 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:

	2003	2002	2001
Income tax computed at statutory income tax rate	₱ 1,315	₱ 1,326	₱ 603
Additions (reductions) resulting from:			
Income subject to income tax holiday (see Note 24)	(288)	(117)	(17)
Interest income subjected to lower final tax and others	(25)	22	74
Provision for income tax	₱ 1,002	₱ 1,231	₱ 660

16. Cost of Goods Sold

	2003	2002	2001
Direct materials	₱ 98,444	₱80,750	₱77,881
Depreciation and amortization	1,190	1,180	1,150
Employee costs	330	345	305
Others	1,389	1,193	1,888
	₱101,353	₱83,468	₱81,224

17. Expenses

a. Operating Expenses

	2003	2002	2001
Employee costs	₱ 979	₱ 921	₱ 860
Depreciation and amortization	924	1,104	1,180
Maintenance and repairs	467	379	412
Purchased services and utilities	422	424	390
Advertising	227	277	273
Provision for doubtful accounts/ accounts vable written-off	199	65	99
Taxes and licenses	197	111	88
Insurance	47	65	42
Materials and office supplies	46	245	289
Entertainment, amusement and representation	14	13	24
Others	–	96	47
	₱ 3,522	₱ 3,700	₱ 3,704

b. Interest

	2003	2002	2001
Interest income:			
Marketable equity securities	₱ 117	₱ 130	₱ 295
Cash in bank	58	59	8
Trade receivables	33	17	13
Product loaning	21	23	44
Investment bonds	4	21	4
Others	2	7	51
	235	257	415
Interest expense:			
Loans	(1,459)	(1,068)	(1,823)
Product borrowings	(34)	–	–
	(1,493)	(1,068)	(1,823)
	(₱1,258)	(₱811)	(₱1,408)

18. Related Party Transactions

The significant transactions with related parties are as follows:

	2003			
Name of Company	Relationship	Nature of transaction	Transaction amount	Balance at end of year
Saudi Aramco	40% stockholder	Crude purchases	₱62,915	₱3,386
PNOC	40% stockholder	Leases	127	–

	2002			
Name of Company	Relationship	Nature of transaction	Transaction amount	Balance at end of year
Saudi Aramco	40% stockholder	Crude purchases	₱45,603	₱2,958
PNOC	40% stockholder	Leases	121	–

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 Philippine National Oil Company (PNOC) until August 2018 covering certain lots where its refinery and other facilities are located. Lease charges on refinery facilities escalate at two percent a year, subject to increase upon reappraisal.

Rental expense amounted to ₱123 in 2003, ₱121 in 2002 and ₱119 in 2001. Total annual rental commitments for the next five years under these agreements are as follows:

Year	Amount
2004	₱129
2005	132
2006	135
2007	137
2008	140

19. Pension Plan

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

As of the most recent valuation date of the Company's pension plan (January 1, 2003), the fair value of the plan assets amounted to ₱3,031. The actuarial present value of pension benefits, based on the assumed rate of return of 9%, amounted to ₱2,536. The excess of the fair value of the plan assets over the actuarial present value of pension benefits amounted to ₱495. Other principal actuarial assumptions used to determine retirement benefits include an expected long-term rate of return on plan assets of 10%, discount rate and average salary increase rate of 9%.

No pension expense was provided in 2003, 2002 and 2001.

20. Supplementary Information

a. Processing License Agreement
The Company was granted by Pennzoil-Quaker State International Corporation (Pennzoil) an exclusive license to blend and package certain Pennzoil products until December 31, 2003. The agreement also includes the license to use certain Pennzoil trademarks and the payment of a royalty fee based on net sales value. Royalty expense amounted to ₱1.55 in 2003, ₱1.97 in 2002 and ₱1.63 in 2001.

The renewal of the contract is currently being negotiated with Pilipinas Shell Petroleum Corporation, the new owner of the Pennzoil trade name.

b. Fuel Supply Contract with National Power Corporation (NPC)
The Company entered into a fuel supply contract with NPC commencing on July 1, 2002 until December 31, 2003. Under the agreement, the Company supplies the bunker fuel and diesel fuel oil requirements to selected NPC plants. Sales revenue amounted to ₱7,769 in 2003, ₱6,529 in 2002 and ₱2,718 in 2001.

To date, the NPC fuel supply contract for 2004 has not been awarded pending the resolution of certain issues relative to the bidding.

25. 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.

Petron'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.

The following tables present revenue and income information and certain asset and liability information regarding the business segments for the years ended December 31, 2003 and 2002. Segment assets and liabilities exclude income tax assets and liabilities.

	Petroleum	Insurance	Leasing	Others	Elimination	Total
Year Ended December 31, 2003						
Revenue						
Total revenue	**₱110,737**	**₱527**	**₱224**	**₱–**	**(₱751)**	**₱110,737**
Segment results	**5,338**	**504**	**206**	**–**	**(186)**	**5,862**
Net income	**3,108**	**130**	**33**	**(1)**	**(162)**	**3,108**
Assets and liabilities						
Segment assets	**50,651**	**1,129**	**2,198**	**50**	**(2,916)**	**51,112**
Segment liabilities	**29,342**	**210**	**1,579**	**1**	**(1,431)**	**29,701**
Other segment information						
Property, plant and equipment	**19,375**	**2**	**2,034**	**–**	**86**	**21,497**
Depreciation and amortization	**2,112**	**–**	**2**	**–**	**–**	**2,114**
Year Ended December 31, 2002						
Revenue						
Total revenue	₱92,330	₱487	₱190	₱–	(₱677)	₱92,330
Segment results	4,716	459	173	–	(186)	5,162
Net income	2,914	153	20	–	(173)	2,914
Assets and liabilities						
Segment assets	48,995	1,010	1,725	–	(2,370)	49,360
Segment liabilities	29,603	238	1,508	–	(1,383)	29,966
Other segment information						
Property, plant and equipment	19,969	2	1,560	–	–	21,531
Depreciation and amortization	2,282	–	2	–	–	2,284

The following tables present additional information on the petroleum business segment of the Company for 2003 and 2002:

	Retail	Lube	Gasul	Industrial	Others	Total
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**
Year Ended December 31, 2002						
Revenue	₱40,275	₱802	₱5,591	₱30,440	₱15,222	₱92,330
Property, plant and equipment	3,862	6	102	68	15,931	19,969

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, 2003 and 2002:

	Petroleum	Insurance	Leasing	Elimination/ Others	Total
Year Ended December 31, 2003					
Revenue					
Local	₱96,472	₱470	₱224	(₱751)	₱96,415
Export/International	14,265	57	–	–	14,322
Year Ended December 31, 2002					
Revenue					
Local	₱81,560	₱403	₱190	(₱677)	₱81,476
Export/International	10,770	84	–	–	10,854

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
Equitable PCI Capital
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.
Bank of New York
BNP Paribas
Citibank, N.A.
Credit Lyonnais
Deutsche Bank
Development Bank of Singapore
Hong Kong and Shanghai Banking
  Corporation
ING Bank, N.V.
JP Morgan Chase Bank
KBC Bank, N.V.
The Bank of Tokyo-Mitsubishi,
  Manila Branch

Citicorp International Limited
ING Barings
JP Morgan Asia Limited
Saudi American Bank
Arab Petroleum Investment
  Corporation
Bank al-Jazira
Hua Nan Commercial Bank, Ltd.,
  Singapore Branch
Mizuho Corporate Bank, Ltd.,
  Hong Kong
Norddeutsche Landesbank
  Girozentrale, Singapore
Sumitomo Mitsui Bank Corporation,
  Hong Kong
The Arab Investment Company S.A.A.
The Bank of Tokyo-Mitsubishi Ltd.,
  Labuan Branch
The Saudi Investment Bank
United World Chinese Commercial
  Bank, Taipei

Products

FUELS

Gasul
Aviation Gasoline
Petron Blaze
Petron XCS Plus with Valvemaster™
Premium Unleaded with XCS
Regular Unleaded
Petron Jet A- I
Petron Gaas
Petron Low Sulfur DieselMax
Petron Industrial Diesel Fuel
Petron Fuel Oil
Petron Intermediate Fuels
Petron Special Fuel Oil
Gas Turbine Fuel
IF - 1

AUTOMOTIVE LUBRICATING OILS

Automotive Engine Oils

Commercial Engine Oils
Rev-X All Terrain
Rev-X Trekker
Rev-X Hauler
Rev-X HD
Petron XD 2040
Petron 2040
Petron Railroad Extra

Service Station Engine Oils
Ultron Race
Ultron Rallye
Ultron Touring
Ultron Extra
Petron MO

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

Straight Mineral Oil
STM

Automotive Gear Oils and Transmission Fluids

Automotive Gear Oils
Petron GX
Petron GEP
Petron GST

Automotive Transmission Fluids
Petron ATF Premium
Petron TF 38
TDH 50

INDUSTRIAL LUBRICATING OILS

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

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

MARINE LUBRICATING OILS

Marine Cylinder Oils
DCL 100
Petromar S

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

Other Marine Lubricants
Petromar 65

GREASES

Multipurpose Greases
Molygrease Premium
Petrogrease Premium
Petrogrease MP

Greases for Extreme Pressure Conditions
Petrogrease EP
Molygrease EP2
Molygrease EP IP and EP 2P
Petrogrease EP 290 and EP 375

High Temperature Grease
Petrogrease HT

Chassis Grease
Petrogrease XX

Special Greases
Petrogrease Aluminum Complex
Petrogrease Food Grade
Petrogrease Lithium Complex with Moly

ASPHALTS

Penetration Asphalts
Petropen

Cutback Asphalts
Petropen CB

Emulsified Asphalt
Petromul CSS -1

Blown Asphalts
Asphaltseal
Asphalt Joint Sealer

SPECIAL PRODUCTS

Process Aids
Process Oils
Product 50 R
Jute Batching Oil
Printsol 600
Rubbex 130
Petron Dust Stop Oil
Aldro Oil
Stemol

Solvents
Solvent 3040
Solvent 1425

Protective Coatings
Petrokote
Petrokote 392
Marinekote
Marinekote SS
Autokote
Cablekote
Cablelube

Heat Transfer Oil
Petrotherm 32

Cleaning Agent
Greasolve

AFTERMARKET SPECIALTIES

Petron Oil Saver
Engine Oil Improver
Lubritop
Diesel Power Booster
Petron Engine Flush
Petron DOT-3 Brake Fluid
Super Coolant
Petromate
Greaseaway
Overglide
Bull's Eye
30 SM

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

Products

FUELS

Gasul
Aviation Gasoline
Petron Blaze
Petron XCS Plus with Valvemaster™
Premium Unleaded with XCS
Regular Unleaded
Petron Jet A- I
Petron Gaas
Petron Low Sulfur DieselMax
Petron Industrial Diesel Fuel
Petron Fuel Oil
Petron Intermediate Fuels
Petron Special Fuel Oil
Gas Turbine Fuel
IF - 1

AUTOMOTIVE LUBRICATING OILS

Automotive Engine Oils

<u>Commercial Engine Oils</u>
Rev-X All Terrain
Rev-X Trekker
Rev-X Hauler
Rev-X HD
Petron XD 2040
Petron 2040
Petron Railroad Extra

<u>Service Station Engine Oils</u>
Ultron Race
Ultron Rallye
Ultron Touring
Ultron Extra
Petron MO

<u>Motorcycle Oils</u>
Petron Sprint 4T
Petron 2T Premium
Petron 2T Autolube
Petron 2T Powerburn
2T Enviro

Straight Mineral Oil
<u>STM</u>

Automotive Gear Oils and Transmission Fluids

<u>Automotive Gear Oils</u>
Petron GX
Petron GEP
Petron GST

<u>Automotive Transmission Fluids</u>
Petron ATF Premium
Petron TF 38
TDH 50

INDUSTRIAL LUBRICATING OILS

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

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

MARINE LUBRICATING OILS

Marine Cylinder Oils
DCL 100
Petromar S

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

Other Marine Lubricants
Petromar 65

GREASES

Multipurpose Greases
Molygrease Premium
Petrogrease Premium
Petrogrease MP

Greases for Extreme Pressure Conditions
Petrogrease EP
Molygrease EP2
Molygrease EP IP and EP 2P
Petrogrease EP 290 and EP 375

High Temperature Grease
Petrogrease HT

Chassis Grease
Petrogrease XX

Special Greases
Petrogrease Aluminum Complex
Petrogrease Food Grade
Petrogrease Lithium Complex with Moly

ASPHALTS

Penetration Asphalts
Petropen

Cutback Asphalts
Petropen CB

Emulsified Asphalt
Petromul CSS -1

Blown Asphalts
Asphaltseal
Asphalt Joint Sealer

SPECIAL PRODUCTS

Process Aids
Process Oils
Product 50 R
Jute Batching Oil
Printsol 600
Rubbex 130
Petron Dust Stop Oil
Aldro Oil
Stemol

Solvents
Solvent 3040
Solvent 1425

Protective Coatings
Petrokote
Petrokote 392
Marinekote
Marinekote SS
Autokote
Cablekote
Cablelube

Heat Transfer Oil
Petrotherm 32

Cleaning Agent
Greasolve

AFTERMARKET SPECIALTIES

Petron Oil Saver
Engine Oil Improver
Lubritop
Diesel Power Booster
Petron Engine Flush
Petron DOT-3 Brake Fluid
Super Coolant
Petromate
Greaseaway
Overglide
Bull's Eye
30 SM

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

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