



November 14, 2012

**Disclosure Department**  
3<sup>rd</sup> Floor, Philippine Stock Exchange Center  
Ayala Triangle, Ayala Avenue  
Makati City

Attention: **Ms. Janet A. Encarnacion**  
Head, Disclosure Department

Dear Ms. Encarnacion:

We are submitting the Company's 3<sup>rd</sup> Quarterly Report (SEC Form 17-Q) for the period ended September 30, 2012.

Thank you.

Very truly yours,

A handwritten signature in blue ink, appearing to read 'Joel'.

**JOEL ANGELO C. CRUZ**  
AVP - General Counsel &  
Corporate Secretary



SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

QUARTERLY REPORT PURSUANT TO SECTION 17 OF THE SECURITIES  
REGULATION CODE AND SRC RULE 17 (2)(b) THEREUNDER

1. For the quarterly period ended September 30, 2012.
2. SEC Identification Number 31171 3. BIR Tax Identification No. 000-168-801
4. Exact name of registrant as specified in its charter PETRON CORPORATION
5. Philippines  
Province, Country or other  
jurisdiction of incorporation or  
organization
6.  (SEC Use Only)  
Industry Classification Code:
7. Mandaluyong City, 40 San Miguel Avenue, 1550  
Address of principal office Postal Code
8. (0632) 886-3888  
Registrant's telephone number, including area code
9. N/A  
(Former name, former address, and former fiscal year, if changed since last report.)
10. Securities registered pursuant to Sections 8 and 12 of the SRC or Sections 4 and 8 of the RSA

Title of Each Class

Number of Shares of Common Stock

Outstanding and Amount of Debt

Outstanding

Common Stock

9,375,104,497 Shares

Preferred Stock

100,000,000 Shares

Total Liabilities

P180,249 million

11. Are any or all of these securities listed on the Philippine Stock Exchange.

Yes  No

If yes, state the name of such stock exchange and the classes of securities listed therein:

Philippine Stock Exchange

Common and Preferred Stocks

12. Indicate by check mark whether the Registrant:

(a) has filed all reports required to be filed by Section 17 of the Code and SRC Rule 17 thereunder or Sections 11 of the RSA and RSA Rule 11 (a)-1 thereunder, and Sections 26 and 141 of the Corporation Code of the Philippines, during the preceding 12 months (or for such shorter period the registrant was required to file such reports).

Yes  No

(b) has been subject to such filing requirements for the past 90 days.

Yes  No

| <b>PART I - FINANCIAL INFORMATION</b> |  |       |
|---------------------------------------|--|-------|
| Item 1                                | Financial Statements   |       |
|                                       |  |       |
|                                       | Petron Corporation & Subsidiaries<br>Consolidated Statements of Financial<br>Position        | 5     |
|                                       |  |       |
|                                       | Petron Corporation & Subsidiaries<br>Consolidated Statements of Income                       | 6     |
|                                       |  |       |
|                                       | Petron Corporation & Subsidiaries<br>Consolidated Statements of Comprehensive<br>Income      | 7     |
|                                       |  |       |
|                                       | Petron Corporation & Subsidiaries<br>Consolidated Statements of Changes in<br>Equity         | 8     |
|                                       |  |       |
|                                       | Petron Corporation & Subsidiaries<br>Consolidated Statements of Cash Flows                   | 9     |
|                                       |  |       |
|                                       | Selected Notes to Consolidated Financial<br>Statements                                       | 10-52 |
|                                       |  |       |
|                                       | Details of Accounts Receivables  | 53    |
|                                       |  |       |
| Item 2                                | Management's Discussion and Analysis of<br>Financial Conditions and Results of<br>Operations | 54-61 |
|                                       |  |       |
| <b>PART II - OTHER INFORMATION</b>    |  |       |
| Other Information                     |  | 62    |
|                                       |  |       |
| <b>SIGNATURES</b>                     |  | 63    |

PART I - FINANCIAL INFORMATION



PETRON CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF FINANCIAL POSITION  
 SEPTEMBER 30, 2012 AND DECEMBER 31, 2011  
 (Amounts in Million Pesos)

|  | Note | 2012      |                | 2011    |                |
|--|------|-----------|----------------|---------|----------------|
|  |      | Unaudited |                | Audited |                |
| <b>ASSETS</b>  |      |           |                |         |                |
| <b>Current Assets</b>  |      |           |                |         |                |
| Cash and cash equivalents  |      |           |                |         |                |
| Financial assets at fair value through profit or loss                    | 8.10 | P         | 21,627         | P       | 23,823         |
| Trade and other receivables - net  | 8.10 |           | 158            |         | 237            |
| Inventories  | 8.10 |           | 43,972         |         | 26,605         |
| Other current assets   |      |           | 60,974         |         | 37,763         |
|  |      |           | 11,807         |         | 8,178          |
|  |      |           | 138,538        |         | 96,606         |
| Assets held for sale   |      |           | 10             |         | 10             |
| <b>Total Current Assets</b>  |      |           | <b>138,548</b> |         | <b>96,616</b>  |
| <b>Noncurrent Assets</b>   |      |           |                |         |                |
| Property, plant and equipment - net                                      |      |           | 84,611         |         | 50,446         |
| Investments in associates  | 4    |           | 1,155          |         | 2,505          |
| Investment property - net  |      |           | 726            |         | 794            |
| Available-for-sale financial assets                                      | 8.10 |           | 927            |         | 1,036          |
| Deferred tax assets  |      |           | 49             |         | 15             |
| Goodwill   |      |           | 10,429         |         | -              |
| Other noncurrent assets - net  | 8.10 |           | 19,000         |         | 24,383         |
| <b>Total Noncurrent Assets</b>   |      |           | <b>116,897</b> |         | <b>79,179</b>  |
|  |      | P         | <b>255,445</b> | P       | <b>175,795</b> |
| <b>LIABILITIES AND EQUITY</b>  |      |           |                |         |                |
| <b>Current Liabilities</b>   |      |           |                |         |                |
| Short-term loans   | 8.10 | P         | 74,293         | P       | 40,593         |
| Liabilities for crude oil and petroleum product importation              | 8.10 |           | 44,435         |         | 13,842         |
| Trade and other payables   | 8.10 |           | 10,142         |         | 7,381          |
| Derivative liabilities   | 8.10 |           | 81             |         | 55             |
| Current portion of long-term debt - net                                  | 8.10 |           | 73             |         | 4,124          |
| Income tax payable   |      |           | 72             |         | 78             |
| <b>Total Current Liabilities</b>   |      |           | <b>129,096</b> |         | <b>66,073</b>  |
| <b>Noncurrent Liabilities</b>  |      |           |                |         |                |
| Long-term debt - net of current portion                                  | 8.10 |           | 45,255         |         | 45,744         |
| Retirement benefits liability  |      |           | 1,473          |         | 671            |
| Deferred tax liabilities   |      |           | 2,691          |         | 1,819          |
| Asset retirement obligation  |      |           | 1,078          |         | 1,061          |
| Other noncurrent liabilities   | 8.10 |           | 656            |         | 740            |
| <b>Total Noncurrent Liabilities</b>                                      |      |           | <b>51,153</b>  |         | <b>50,035</b>  |
| <b>Equity Attributable to Equity Holders of the Parent Company</b>       |      |           |                |         |                |
| Capital stock  |      |           | 9,475          |         | 9,475          |
| Additional paid-in capital   |      |           | 9,764          |         | 9,764          |
| Retained earnings  |      |           | 38,618         |         | 40,088         |
| Other reserves   |      |           | (190)          |         | 70             |
| <b>Total Equity Attributable to Equity Holders of the Parent Company</b> |      |           | <b>57,667</b>  |         | <b>59,397</b>  |
| Non-controlling interests  |      |           | 17,529         |         | 290            |
| <b>Total Equity</b>  |      |           | <b>75,196</b>  |         | <b>59,687</b>  |
|  |      | P         | <b>255,445</b> | P       | <b>175,795</b> |

Note the accompanying Management Discussion and Analysis and related notes to Consolidated Financial Statements.


Certified by:   
 EFREN P. BARILLO  
 Vice President, Controller



**PETRON CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2012 AND 2011**  
 (Amounts in Million Pesos, Except Per Share Amounts)  
**UNAUDITED**

|   | Note | July to September |          | January to September |           |
|---|------|-------------------|----------|----------------------|-----------|
|   |      | 2012              | 2011     | 2012                 | 2011      |
| SALES   | 2 P  | 114,042           | P 67,032 | P 307,341            | P 201,929 |
| COST OF GOODS SOLD  |      | 109,568           | 62,601   | 293,895              | 183,638   |
| GROSS PROFIT  |      | 4,474             | 4,431    | 13,446               | 18,291    |
| SELLING AND ADMINISTRATIVE EXPENSES   |      | (2,333)           | (1,988)  | (6,906)              | (4,856)   |
| INTEREST INCOME   |      | 224               | 309      | 873                  | 1,007     |
| INTEREST EXPENSE AND OTHER FINANCING CHARGES  |      | (1,680)           | (1,256)  | (5,760)              | (3,879)   |
| SHARE IN NET LOSS OF ASSOCIATES   |      | (26)              | (66)     | (4)                  | (169)     |
| OTHER INCOME (CHARGES) - net  |      | (208)             | 632      | (539)                | (281)     |
| INCOME BEFORE INCOME TAX  |      | 451               | 2,062    | 1,110                | 10,113    |
| INCOME TAX EXPENSE (BENEFIT)  |      | (49)              | 507      | 178                  | 3,513     |
| NET INCOME  |      | P 500             | P 1,555  | P 932                | P 7,600   |
| Attributable to:  |      |                   |          |                      |           |
| Equity Holders of the Parent Company  | 6 P  | 191               | 1,551    | P 886                | P 7,581   |
| Non-controlling Interests   |      | 309               | 4        | 46                   | 19        |
|   |      | P 500             | P 1,555  | P 932                | P 7,600   |
| BASIC DILUTED EARNINGS (LOSS) PER COMMON SHARE<br>ATTRIBUTABLE TO EQUITY HOLDERS<br>OF THE PARENT COMPANY | 6 P  | (0.03)            | P 0.14   | P (0.01)             | P 0.73    |

Note: See accompanying Management Discussion and Analysis and Selected Notes to Consolidated Financial Statements.

Certified by:   
**EFREN P. CABRILLO**  
 Vice President Controller

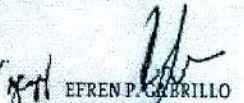


PETRON CORPORATION AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
FOR THE PERIOD ENDED SEPTEMBER 30, 2012 AND 2011  
(Amounts in Million Pesos)  
UNAUDITED

|   | July to September |         | January to September |         |
|---|-------------------|---------|----------------------|---------|
|   | 2012              | 2011    | 2012                 | 2011    |
| NET INCOME  | P 500             | P 1,555 | P 932                | P 7,600 |
| NET GAIN ON AVAILABLE-FOR-SALE<br>FINANCIAL ASSETS - NET OF TAX | 20                | 1       | 12                   | -       |
| EXCHANGE DIFFERENCES ON TRANSLATION<br>OF FOREIGN OPERATIONS    | 199               | (13)    | (782)                | (7)     |
| OTHER COMPREHENSIVE INCOME (LOSS) - NET OF TAX                  | 219               | (12)    | (770)                | (7)     |
| TOTAL COMPREHENSIVE INCOME                                      | P 719             | P 1,543 | P 162                | P 7,593 |
| Comprehensive Income Attributable to:                           |                   |         |                      |         |
| Equity holders of the Parent Company                            | P 920             | P 1,538 | P 626                | P 7,573 |
| Non-controlling Interests                                       | (201)             | 5       | (464)                | 20      |
|   | P 719             | P 1,543 | P 162                | P 7,593 |

Note: See accompanying Management Discussion and Analysis and Selected Notes to Consolidated Financial Statements.

Certified by:

  
EFREN P. CEBRILLO  
Vice President/Controller






PETRON CORPORATION AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY  
 FOR THE PERIOD ENDED SEPTEMBER 30, 2012 AND 2011  
 (Amounts in Million Pesos)

|   | Equity Attributable to Equity Holders of the Parent Company |                 |                                  |                     |          |          |                   |          |                                 |
|---|---|-----------------|----------------------------------|---------------------|----------|----------|-------------------|----------|---------------------------------|
|   | Preferred<br>Stock  | Common<br>Stock | Additional<br>paid-in<br>capital | Retained Earnings   |          |          | Other<br>Reserves | Total    | Non-<br>controlling<br>Interest |
| Appro-<br>priated                                     |   |                 |                                  | Unappro-<br>priated |          |          |                   |          |                                 |
| Balance at January 1, 2012 (Audited)                  | P 100   | P 9,375         | P 9,764                          | P 25,171            | P 14,917 | P 70     | P 59,397          | P 290    | P 59,687                        |
| Total comprehensive income                            |   |                 |                                  |                     | 886      | (260)    | 626               | (464)    | 162                             |
| Cash dividends (Note 7)                               |   |                 |                                  |                     | (2,356)  |          | (2,356)           |          | (2,356)                         |
| Net additions to non-controlling interests and others |   |                 |                                  |                     |          |          |                   | 17,703   | 17,703                          |
| Balance at September 30, 2012 (Unaudited)             | P 100   | P 9,375         | P 9,764                          | P 25,171            | P 13,447 | ( P 190) | P 57,667          | P 17,529 | P 75,196                        |
| Balance at January 1, 2011 (Audited)                  | P 100   | P 9,375         | P 9,764                          | P 15,543            | P 18,205 | P 83     | P 53,070          | P 274    | P 53,344                        |
| Total comprehensive income                            |   |                 |                                  |                     | 7,582    | (9)      | 7,573             | 20       | 7,593                           |
| Appropriation for capital projects                    |   |                 |                                  | 9,638               | (9,638)  |          |                   |          |                                 |
| Cash dividends (Note 7)                               |   |                 |                                  |                     | (1,652)  |          | (1,652)           |          | (1,652)                         |
| Balance at September 30, 2011 (Unaudited)             | P 100   | P 9,375         | P 9,764                          | P 25,181            | P 14,497 | P 74     | P 58,991          | P 294    | P 59,285                        |

Note: See accompanying Management Discussion and Analysis and Selected Notes to Consolidated Financial Statements.

Certified by:

  
 EFREN P. FABRILLO  
 Vice President Controller



**PETRON CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE PERIOD ENDED SEPTEMBER 30, 2012 AND 2011**  
 (Amounts in Million Pesos)  
**UNAUDITED**

|  | 2012     |                 | 2011     |                 |
|--|----------|-----------------|----------|-----------------|
|  | P        |                 | P        |                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>                            |          |                 |          |                 |
| Income before income tax   |          | 1,110           |          | 10,113          |
| Adjustments for:   |          |                 |          |                 |
| Share in net loss of an associate                                      |          | 4               |          | 169             |
| Depreciation and amortization  |          | 3,628           |          | 2,705           |
| Interest expense   |          | 5,760           |          | 3,879           |
| Interest income  |          | (873)           |          | (1,007)         |
| Net unrealized foreign exchange (gain) loss                            |          | (488)           |          | 171             |
| Others   |          | (561)           |          | (69)            |
| Operating income before working capital changes                        |          | 8,580           |          | 15,961          |
| Changes in operating assets and liabilities                            |          |                 |          |                 |
| Increase in assets:  |          |                 |          |                 |
| Receivables  |          | (1,001)         |          | (3,181)         |
| Inventories  |          | (10,051)        |          | (18,943)        |
| Other current assets   |          | (3,610)         |          | (1,903)         |
| Increase (decrease) in liabilities:                                    |          |                 |          |                 |
| Liabilities for crude oil and petroleum product importation            |          | 14,059          |          | 10,466          |
| Accounts payable and accrued expenses and others                       |          | (62)            |          | 360             |
| Provisions for doubtful accounts, inventory obsolescence and others    |          | 256             |          | 54              |
| Interest paid  |          | (5,085)         |          | (3,953)         |
| Income taxes paid  |          | (603)           |          | (520)           |
| Interest received  |          | 232             |          | 1,038           |
| <b>Net cash flows provided by (used in) operating activities</b>       |          | <b>3,435</b>    |          | <b>(641)</b>    |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>                            |          |                 |          |                 |
| Additions to:  |          |                 |          |                 |
| Property, plant and equipment  |          | (22,407)        |          | (30,635)        |
| Investment properties  |          | -               |          | (698)           |
| Decrease (increase) in:  |          |                 |          |                 |
| Other receivables  |          | (3,761)         |          | (329)           |
| Other noncurrent assets  |          | 12,161          |          | 316             |
| Reductions from (additions to):  |          |                 |          |                 |
| Financial assets at fair value through profit or loss                  |          | 29              |          | (104)           |
| Available-for-sale investments   |          | 109             |          | 127             |
| Acquisition of subsidiaries, net of cash and cash equivalents acquired |          | (19,090)        |          | -               |
| Investments  |          | (15)            |          | (1,734)         |
| <b>Net cash flows used in investing activities</b>                     |          | <b>(32,974)</b> |          | <b>(32,057)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                            |          |                 |          |                 |
| Availment of loans   |          | 333,786         |          | 55,031          |
| Payments of:   |          |                 |          |                 |
| Loans  |          | (218,229)       |          | (63,445)        |
| Cash dividends   |          | (2,205)         |          | (1,640)         |
| Issuance of Preferred Share by a subsidiary                            |          | 14,216          |          | -               |
| Others   |          | (117)           |          | 107             |
| <b>Net cash flows provided by (used in) financing activities</b>       |          | <b>27,451</b>   |          | <b>(9,947)</b>  |
| <b>EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>   |          |                 |          |                 |
|  |          | (88)            |          | 60              |
| <b>NET DECREASE IN CASH AND CASH EQUIVALENTS</b>                       |          | <b>(2,196)</b>  |          | <b>(23,585)</b> |
| <b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>                  |          | <b>23,823</b>   |          | <b>43,984</b>   |
| <b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>                      | <b>P</b> | <b>21,627</b>   | <b>P</b> | <b>20,399</b>   |

Note: See accompanying Management Discussion and Analysis and Selected Notes to Consolidated Financial Statements.

Certified by:

  
**EFREN M. ABRILLO**  
 Vice President Controller

**PETRON CORPORATION AND SUBSIDIARIES**  
**SELECTED NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(Amounts in Millions, Except Per Share Data)

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**1. Summary of Significant Accounting and Financial Reporting Policies**

Petron Corporation (Petron or Parent Company) and its subsidiaries (collectively referred to as the "Group") prepared its consolidated interim financial statements as of and for the period ended September 30, 2012 and comparative financial statements for the same period in 2011 following the new presentation rules under Philippine Accounting Standard (PAS) No. 34, Interim Financial Reporting. The consolidated financial statements of the Group have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

The consolidated financial statements are presented in Philippine peso and all values are rounded off to the nearest million (000,000), except when otherwise indicated.

The principal accounting policies and methods adopted in preparing the interim consolidated financial statements of the Group are the same as those followed in the most recent annual audited financial statements.

Adoption of New Standards, Amendments to Standards and Interpretations

The Financial Reporting Standards Council (FRSC) approved the adoption of a number of new or revised standards, amendments to standards, and interpretations [based on International Financial Reporting Interpretation Committee (IFRIC) Interpretations] as part of PFRS.

*Amendments to Standards and Interpretations Adopted in 2012*

The Group has adopted the following PFRS starting January 1, 2012 and accordingly, changed its accounting policies in the following areas:

- *Disclosures - Transfers of Financial Assets (Amendments to PFRS 7, Financial Instruments, Disclosure)*, requires additional disclosures about transfers of financial assets. The amendments require disclosure of information that enables users of financial statements to understand the relationship between transferred financial assets that are not derecognized in their entirety and the associated liabilities; and to evaluate the nature of, and risks associated with, the entity's continuing involvement in derecognized financial assets. Entities are required to apply the amendments for annual periods beginning on or after July 1, 2011.
- *Deferred Tax: Recovery of Underlying Assets (Amendments to PAS 12, Income Taxes)* introduces an exception to the current measurement principles of deferred tax assets and liabilities arising from investment property measured using the fair value model in accordance with PAS 40, *Investment Property*. The exception also applies to investment properties acquired in a business combination accounted for in accordance with PFRS 3 provided the acquirer subsequently measure these assets applying the fair value model. The amendments

integrated the guidance of Philippine Interpretation Standards Interpretation Committee (SIC) - 21, *Income Taxes - Recovery of Revalued Non-Depreciable Assets* into PAS 12, and as a result Philippine Interpretation SIC - 21 has been withdrawn. The effective date of the amendments is for periods beginning on or after January 1, 2012 and will be applied retrospectively.

The adoption of these foregoing new or revised standards, amendments to standards and Philippine Interpretations of IFRIC did not have a material effect on the interim consolidated financial statements.

#### *New or Revised Standards, Amendments to Standards and Interpretations Not Yet Adopted*

A number of new or revised standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2012, and have not been applied in preparing the consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for PFRS 11, *Joint Arrangements*, which will become mandatory for the Group's 2013 financial statements and will require the equity method for joint ventures and PFRS 9, *Financial Instruments*, which becomes mandatory for the Group's 2015 consolidated financial statements and could change the classification and measurement of financial assets. The Group conducted an evaluation on the possible financial impact of the adoption of PFRS 9 and does not plan to adopt this standard early.

The Group will adopt the following new or revised standards, amendments to standards and interpretations on the respective effective dates:

- Presentation of Items of Other Comprehensive Income (*Amendments to PAS 1, Presentation of Financial Statements*). The amendments: (a) require that an entity present separately the items of other comprehensive income that would be reclassified to profit or loss in the future if certain conditions are met from those that would never be reclassified to profit or loss; (b) do not change the existing option to present profit or loss and other comprehensive income in two statements; and (c) change the title of the statement of comprehensive income to statement of profit or loss and other comprehensive income. However, an entity is still allowed to use other titles. The amendments do not address which items are presented in other comprehensive income or which items need to be reclassified. The requirements of other PFRS continue to apply in this regard. The effective date of the amendment is for periods beginning on or after January 1, 2013.
- PFRS 10, *Consolidated Financial Statements*, introduces a new approach to determining which investees should be consolidated and provides a single model to be applied in the control analysis for all investees. An investor controls an investee when: (a) it is exposed or has rights to variable returns from its involvement with that investee; (b) it has the ability to affect those returns through its power over that investee; and (c) there is a link between power and returns. Control is reassessed as facts and circumstances change. PFRS 10 supersedes PAS 27, *Consolidated and Separate Financial Statements* (2008). The new standard is effective for annual periods beginning on or after January 1, 2013.

- PFRS 11, *Joint Arrangements*, focuses on the rights and obligations of joint arrangements, rather than the legal form (as is currently the case). It: (a) distinguishes joint arrangements between joint operations and joint ventures; and (b) always requires the equity method for jointly controlled entities that are now called joint ventures; they are stripped of the free choice of using the equity method or proportionate consolidation. PFRS 11 supersedes PAS 31 and Philippine Interpretation SIC-13, *Jointly Controlled Entities – Non-Monetary Contributions by Venturers*. The new standard is effective for annual periods beginning on or after January 1, 2013.
- PFRS 12, *Disclosure of Interests in Other Entities*, contains the disclosure requirements for entities that have interests in subsidiaries, joint arrangements (i.e., joint operations or joint ventures), associates and/or unconsolidated structured entities, aiming to provide information to enable users to evaluate the nature of, and risks associated with, an entity's interests in other entities; and the effects of those interests on the entity's financial position, financial performance and cash flows. The new standard is effective for annual periods beginning on or after January 1, 2013.
- PFRS 13, *Fair Value Measurement*, replaces the fair value measurement guidance contained in individual PFRS with a single source of fair value measurement guidance. It defines fair value, establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. It explains how to measure fair value when it is required or permitted by other PFRS. It does not introduce new requirements to measure assets or liabilities at fair value nor does it eliminate the practicability exceptions to fair value measurements that currently exist in certain standards. The new standard is effective for annual periods beginning on or after January 1, 2013. Early application is permitted and required to be disclosed.
- PAS 19, *Employee Benefits* (amended 2011), includes the following requirements: (a) actuarial gains and losses are recognized immediately in other comprehensive income; this change will remove the corridor method and eliminate the ability for entities to recognize all changes in the defined benefit obligation and in plan assets in profit or loss, which is currently allowed under PAS 19; and (b) expected return on plan assets recognized in profit or loss is calculated based on the rate used to discount the defined benefit obligation. The adoption of the amended or revised standard is required for annual periods beginning on or after January 1, 2013.
- PAS 27, *Separate Financial Statements* (2011), supersedes PAS 27 (2008). PAS 27 (2011) carries forward the existing accounting and disclosure requirements for separate financial statements, with some minor clarifications. The adoption of the amendment is required for annual periods beginning on or after January 1, 2013.
- PAS 28, *Investments in Associates and Joint Ventures* (2011), supersedes PAS 28 (2008). PAS 28 (2011) makes the following amendments: (a) PFRS 5, *Noncurrent Assets Held for Sale and Discontinued Operations*, applies to an investment, or a portion of an investment, in an associate or a joint venture that meets the criteria to be classified as held for sale; and, (b) on cessation of significant influence or joint control, even if an investment in an associate

becomes an investment in a joint venture or *vice versa*, the entity does not remeasure the retained interest. The adoption of the amended or revised standard is required for annual periods beginning on or after January 1, 2013.

- PFRS 9, *Financial Instruments* (2009) is the first standard issued as part of a wider project to replace PAS 39. PFRS 9 (2009) retains but simplifies the mixed measurement model and establishes two primary measurement categories for financial assets: amortized cost and fair value. The basis of classification depends on the entity's business model and the contractual cash flow characteristics of the financial asset. The guidance in PAS 39 on impairment of financial assets and hedge accounting continues to apply. Prior periods need not be restated if an entity adopts the standard for reporting periods beginning before January 1, 2012. PFRS 9 (2010) adds the requirements related to the classification and measurement of financial liabilities, and derecognition of financial assets and liabilities to the version issued in November 2009. It also includes those paragraphs of PAS 39 dealing with how to measure fair value and accounting for derivatives embedded in a contract that contains a host that is not a financial asset, as well as the requirements of Philippine Interpretation - IFRIC 9, *Reassessment of Embedded Derivatives*. The adoption of the new standard is required for annual periods beginning on or after January 1, 2015.
- Philippine Interpretation IFRIC-15, *Agreements for the Construction of Real Estate*, applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. It provides guidance on the recognition of revenue among real estate developers for sales of units, such as apartments or houses, 'off plan'; i.e., before construction is completed. It also provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of PAS 11, *Construction Contracts*, or PAS 18, *Revenue*, and the timing of revenue recognition. The Philippine Securities and Exchange Commission (SEC) issued a notice dated August 5, 2011 that defers the adoption of this interpretation indefinitely.

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## 2. Segment Information

Management identifies segments based on business and geographic locations. These operating segments are monitored and strategic decisions are made on the basis of adjusted segment operating results. The Chief Executive Officer (the chief operating decision maker) reviews management reports on a regular basis.

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

- a. Sales of 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.

- c. Lease of acquired real estate properties for petroleum, refining, storage and distribution facilities, gasoline service stations and other related structures.
- d. Sales on wholesale or retail and operation of service stations, retail outlets, restaurants, convenience stores and the like.
- e. Export sales of various petroleum and non-fuel products to other Asian countries such as South Korea, Taiwan, China, Singapore, Cambodia, Malaysia, and Indonesia.

#### Segment Assets and Liabilities

Segment assets include all operating assets used by a segment and consist principally of operating cash, receivables, inventories, and property, plant and equipment, net of allowances and impairment. Segment liabilities include all operating liabilities and consist principally of accounts payable, wages, taxes currently payable and accrued liabilities. Segment assets and liabilities do not include deferred taxes.

#### Inter-segment Transactions

Segment revenues, expenses and performance include sales and purchases between operating segments. Transfer prices between operating segments are set on an arm's length basis in a manner similar to transactions with third parties. Such transfers are eliminated in consolidation.

The following tables present revenue and income information and certain asset and liability information regarding the business segments as of September 30, 2012 and December 31, 2011 and for the nine months ended September 30, 2012 and 2011. Segment assets and liabilities exclude deferred tax assets and deferred tax liabilities:

|                                 | Petroleum | Insurance | Leasing | Marketing | Elimination | Total    |
|---------------------------------|-----------|-----------|---------|-----------|-------------|----------|
| <u>Period Ended</u>             |           |           |         |           |             |          |
| <u>September 30, 2012</u>       |           |           |         |           |             |          |
| Revenue                         |           |           |         |           |             |          |
| External Sales                  | P305,521  | P -       | P -     | P1,820    | P -         | P307,341 |
| Inter-segment Sales             | 142,407   | 86        | 273     | -         | (142,766)   | -        |
| Segment results                 | 6,142     | 67        | 104     | 51        | 176         | 6,540    |
| Net income                      | 1,078     | 117       | 13      | 66        | (342)       | 932      |
| <u>As of September 30, 2012</u> |           |           |         |           |             |          |
| Assets and liabilities          |           |           |         |           |             |          |
| Segment assets                  | 292,183   | 1,859     | 4,496   | 1,224     | (44,366)    | 255,396  |
| Segment liabilities             | 203,850   | 473       | 3,547   | 475       | (30,786)    | 177,559  |
| Other segment information       |           |           |         |           |             |          |
| Property, plant and equipment   | 80,138    | -         | -       | 248       | 4,225       | 84,611   |
| Depreciation and amortization   | 3,600     | -         | -       | 28        | -           | 3,628    |

|                                  | Petroleum | Insurance | Leasing | Marketing | Elimination | Total    |
|----------------------------------|-----------|-----------|---------|-----------|-------------|----------|
| <u>Period Ended</u>              |           |           |         |           |             |          |
| <u>September 30, 2011</u>        |           |           |         |           |             |          |
| <u>Revenue</u>                   |           |           |         |           |             |          |
| External Sales                   | P200,702  | P -       | P -     | P1,227    | P -         | P201,929 |
| Inter-segment Sales              | 159,033   | 89        | 265     | -         | (159,387)   | -        |
| Segment results                  | 12,588    | 70        | 123     | 65        | 268         | 13,114   |
| Net income                       | 7,581     | 120       | 32      | 75        | (208)       | 7,600    |
| <u>As of Dec. 31, 2011</u>       |           |           |         |           |             |          |
| <u>Assets and liabilities</u>    |           |           |         |           |             |          |
| Segment assets                   | 183,449   | 1,834     | 3,954   | 918       | (14,375)    | 175,780  |
| Segment liabilities              | 124,123   | 146       | 3,018   | 224       | (13,222)    | 114,289  |
| <u>Other segment information</u> |           |           |         |           |             |          |
| Property, plant and equipment    | 46,465    | -         | -       | 205       | 3,776       | 50,446   |
| Depreciation and amortization    | 3,615     | -         | -       | 42        | -           | 3,657    |

The following tables present additional information on the petroleum business segment as of September 30, 2012 and December 31, 2011 and for the nine months ended September 30, 2012 and 2011:

|                                      | Retail  | Lube   | Gasul   | Industrial | Others   | Total    |
|--------------------------------------|---------|--------|---------|------------|----------|----------|
| <u>Property, plant and equipment</u> |         |        |         |            |          |          |
| As of September 30, 2012             | P8,708  | P234   | P351    | P90        | P70,754  | P80,137  |
| As of December 31, 2011              | 5,189   | 279    | 205     | 78         | 44,695   | 50,446   |
| <u>Capital Expenditures</u>          |         |        |         |            |          |          |
| As of September 30, 2012             | P812    | P-     | P157    | P26        | P38,716  | P39,711  |
| As of December 31, 2011              | 303     | -      | 11      | -          | 17,854   | 18,168   |
| <u>Revenue</u>                       |         |        |         |            |          |          |
| Period ended                         |         |        |         |            |          |          |
| September 30, 2012                   | P84,238 | P2,183 | P15,549 | P87,045    | P117,797 | P306,812 |
| Period ended                         |         |        |         |            |          |          |
| September 30, 2011                   | 79,885  | 1,855  | 14,668  | 78,187     | 26,822   | 201,417  |



## Geographical Segments

The following table presents revenue information regarding the geographical segments of the Group for the nine months ended September 30, 2012 and 2011.

|                           | <u>Petroleum</u> | <u>Insurance</u> | <u>Leasing</u> | <u>Marketing</u> | <u>Elimination</u> | <u>Total</u> |
|---------------------------|------------------|------------------|----------------|------------------|--------------------|--------------|
| <u>Period ended</u>       |                  |                  |                |                  |                    |              |
| <u>September 30, 2012</u> |                  |                  |                |                  |                    |              |
| Revenue                   |                  |                  |                |                  |                    |              |
| Local                     | P198,295         | P48              | P273           | P1,820           | (P2,182)           | P198,254     |
| Export/International      | 249,633          | 38               | -              | -                | (140,584)          | 109,087      |
| <u>Period ended</u>       |                  |                  |                |                  |                    |              |
| <u>September 30, 2011</u> |                  |                  |                |                  |                    |              |
| Revenue                   |                  |                  |                |                  |                    |              |
| Local                     | P181,085         | P56              | P265           | P1,227           | (P1,742)           | P180,891     |
| Export/International      | 178,650          | 33               | -              | -                | (157,645)          | 21,038       |

### **3. Related Party Transactions**

The Parent Company, certain subsidiaries and their shareholders and associates, in the normal course of business, purchase products and services from one another. Transactions with related parties are made at normal market prices and terms. An assessment is undertaken at each financial year by examining the financial position of the related party and the market in which the related party operates.

#### Transactions with Current Owners/Related Parties

- Sales relate to the Parent Company's supply agreements with various subsidiaries of San Miguel Corporation (SMC). Under these agreements, the Parent Company supplies the bunker, diesel fuel and lube requirements of selected SMC plants and subsidiaries.
- Purchases relate to purchase of goods and services such as construction, information technology and shipping.
- The Parent Company entered into a lease agreement with San Miguel Properties, Inc. (SMPI) for its office space covering 6,759 square meters with a monthly rate of P4.7. The lease, which commenced on June 1, 2012, is for a period of one year and may be renewed in accordance with the written agreement of the parties.
- The Parent Company also pays SMC for its share in common expenses such as utilities and administrative fees.
- The Parent Company advanced certain monies to the Petron Corporation Employees' Retirement Plan (PCERP) for some investment opportunities.

The balances and transactions with related parties as of September 30, 2012 and December 31, 2011 follow:

September 30, 2012

| <u>Related Parties</u>                          | <u>Relationship With Related Parties</u> | <u>Revenue from Related Parties</u> | <u>Purchases from Related Parties</u> | <u>Amounts Owed by Related Parties</u> | <u>Amounts Owed to Related Parties</u> |
|---|--|-------------------------------------|---------------------------------------|--|--|
| SMC   | Ultimate Parent                          | P1                                  | P128                                  | P1                                     | P33                                    |
| San Miguel Brewery Inc.                         | Under common control                     | 726                                 | 115                                   | 81                                     | 58                                     |
| San Miguel Yamamura Packaging Corporation       | Under common control                     | 564                                 | 3                                     | 68                                     | -                                      |
| SMC Shipping & Lighterage Corporation           | Under common control                     | 345                                 | 646                                   | 33                                     | 40                                     |
| Ginebra San Miguel, Inc. and Subsidiaries       | Under common control                     | 510                                 | 3                                     | 165                                    | -                                      |
| San Miguel Energy Corporation                   | Under common control                     | 132                                 | 378                                   | 43                                     | 54                                     |
| San Miguel Yamamura Asia Corporation            | Under common control                     | 590                                 | -                                     | 77                                     | -                                      |
| Challenger Aero Air Corporation                 | Under common control                     | 14                                  | -                                     | 5                                      | -                                      |
| Mindanao Corrugated Fibreboard, Inc.            | Under common control                     | 43                                  | -                                     | 4                                      | -                                      |
| San Miguel Pure Foods Co, Inc. and Subsidiaries | Under common control                     | 396                                 | 2                                     | 71                                     | -                                      |
| Archen Technologies, Inc.                       | Under common control                     | 7                                   | 233                                   | 2                                      | 92                                     |
| SMPI  | Under common control                     | -                                   | 38                                    | 69                                     | 257                                    |
| Others  | Under common control                     | 1                                   | 90                                    | 4                                      | 45                                     |
|   |  | <b>P3,328</b>                       | <b>P1,636</b>                         | <b>P623</b>                            | <b>P579</b>                            |

December 31, 2011

| <b>Related Parties</b>                          | <b>Relationship With Related Parties</b> | <b>Revenue from Related Parties</b> | <b>Purchases from Related Parties</b> | <b>Amounts Owed by Related Parties</b> | <b>Amounts Owed to Related Parties</b> |
|---|--|-------------------------------------|---------------------------------------|--|--|
| SMC   | Ultimate Parent                          | P1                                  | P76                                   | P -                                    | P20                                    |
| Pan Asia Energy Holdings Inc.                   | Under common control                     | 577                                 | -                                     | -                                      | -                                      |
| San Miguel Brewery Inc.                         | Under common control                     | 934                                 | 140                                   | 111                                    | 19                                     |
| San Miguel Yamamura Packaging Corporation       | Under common control                     | 708                                 | -                                     | 96                                     | -                                      |
| SMC Shipping & Lighterage Corporation           | Under common control                     | 420                                 | 858                                   | 41                                     | 32                                     |
| Ginebra San Miguel, Inc. and Subsidiaries       | Under common control                     | 674                                 | 13                                    | 147                                    | 4                                      |
| San Miguel Energy Corporation                   | Under common control                     | 146                                 | 603                                   | 33                                     | 52                                     |
| San Miguel Yamamura Asia Corporation            | Under common control                     | 775                                 | -                                     | 83                                     | -                                      |
| Challenger Aero Air Corporation                 | Under common control                     | 30                                  | -                                     | 16                                     | -                                      |
| Mindanao Corrugated Fibreboard, Inc.            | Under common control                     | 43                                  | -                                     | 9                                      | -                                      |
| San Miguel Pure Foods Co.,Inc. and Subsidiaries | Under common control                     | 484                                 | 2                                     | 90                                     | 5                                      |
| Archen Technologies, Inc.                       | Under common control                     | 12                                  | 343                                   | -                                      | 130                                    |
| SMPI  | Under common control                     | -                                   | 418                                   | 95                                     | 367                                    |
| Others  | Under common control                     | 37                                  | 90                                    | 24                                     | 23                                     |
|   |  | <b>P4,841</b>                       | <b>P2,543</b>                         | <b>P745</b>                            | <b>P652</b>                            |

#### 4. Property, Plant and Equipment

This account consists of:

|   | Buildings<br>and<br>Related<br>Facilities | Refinery<br>and Plant<br>Equipment | Service<br>Stations<br>and Other<br>Equipment | Computers,<br>Office and<br>Motor<br>Equipment | Land and<br>Leasehold<br>Improvements | Construction<br>In-progress | Total          |
|---|---|------------------------------------|---|--|---------------------------------------|-----------------------------|----------------|
| <b>Cost:</b>  |   |                                    |   |  |                                       |                             |                |
| December 31, 2010   | P13,871                                   | P37,292                            | P5,353  | P2,145   | P4,526                                | P2,796                      | P65,983        |
| Additions   | 555                                       | 524                                | 831   | 1,002  | 526                                   | 17,904                      | 21,342         |
| Disposals/reclassifications                                 | (251)                                     | (6)                                | (115)   | (77)   | 473                                   | (2,532)                     | (2,508)        |
| December 31, 2011   | 14,175                                    | 37,810                             | 6,069   | 3,070  | 5,525                                 | 18,168                      | 84,817         |
| Additions   | 194                                       | 22                                 | 702   | 383  | 355                                   | 21,279                      | 22,935         |
| Disposals/reclassifications/<br>acquisition of a subsidiary | 8,106                                     | 11,565                             | 7,197   | 853  | 3,981                                 | 272                         | 31,974         |
| Currency translation<br>adjustment                          | (225)                                     | (319)                              | (200)   | (25)   | (107)                                 | (8)                         | (884)          |
| <b>September 30, 2012</b>                                   | <b>22,250</b>                             | <b>49,078</b>                      | <b>13,768</b>                                 | <b>4,281</b>                                   | <b>9,754</b>                          | <b>39,711</b>               | <b>138,842</b> |
| <b>Accumulated depreciation<br/>and amortization:</b>       |   |                                    |   |  |                                       |                             |                |
| December 31, 2010   | 7,621                                     | 16,552                             | 3,756   | 1,728  | 1,369                                 | -                           | 31,026         |
| Additions   | 721                                       | 2,027                              | 504   | 219  | 93                                    | -                           | 3,564          |
| Disposals/reclassifications                                 | (113)                                     | (1)                                | (38)  | (67)   | -                                     | -                           | (219)          |
| December 31, 2011   | 8,229                                     | 18,578                             | 4,222   | 1,880  | 1,462                                 | -                           | 34,371         |
| Additions   | 750                                       | 1,692                              | 649   | 240  | 41                                    | -                           | 3,372          |
| Disposals/reclassifications/<br>acquisition of a subsidiary | 4,290                                     | 7,818                              | 4,175   | 684  | (8)                                   | -                           | 16,959         |
| Currency translation<br>adjustment                          | (118)                                     | (217)                              | (116)   | (20)   | -                                     | -                           | (471)          |
| <b>September 30, 2012</b>                                   | <b>13,151</b>                             | <b>27,871</b>                      | <b>8,930</b>                                  | <b>2,784</b>                                   | <b>1,495</b>                          | <b>-</b>                    | <b>54,231</b>  |
| <b>Net book value:</b>                                      |   |                                    |   |  |                                       |                             |                |
| December 31, 2011   | P5,946                                    | P19,232                            | P1,847  | P1,190   | P4,063                                | P18,168                     | P50,446        |
| <b>September 30, 2012</b>                                   | <b>P9,099</b>                             | <b>P21,207</b>                     | <b>P4,838</b>                                 | <b>P1,497</b>                                  | <b>P8,259</b>                         | <b>P39,711</b>              | <b>P84,611</b> |

#### Capital Commitments

As of September 30, 2012 and December 31, 2011, the Group has outstanding commitments to acquire property, plant and equipment amounting to P2,820 and P4,278, respectively.

#### 5. Significant Agreements

##### Lease Agreement

*Lease Agreement with Philippine National Oil Company (PNOC).* On September 30, 2009, New Ventures Realty Corporation (NVR) entered into a 30-year lease with PNOC without rent-free period, covering a property which it shall use for refinery, commencing January 1, 2010 and ending on December 31, 2039. The annual rental shall be P93 payable on the 15th day of January each year without the necessity of demand. This non-cancelable lease is subject to renewal options and annual escalation clauses of 3% per annum up to 2011. The leased premises shall be reappraised starting 2012 and every fifth year thereafter in which the new rental rate shall be

determined equivalent to 5% of the reappraised value, and still subject to annual escalation clause of 3% for the four years following the appraisal. Reappraisal of leased premises for 2012 is on-going. Prior to this agreement, Petron had an outstanding lease agreement on the same property from PNOC. Also, as of September 30, 2012, Petron leases other parcels of land from PNOC for its bulk plants and service stations.

### Fuel Supply Contract

*Fuel Supply Contract with National Power Corporation (NPC) and Power Sector Assets and Liabilities Management Corporation (PSALM).* The Parent Company entered into various fuel supply contracts with NPC and PSALM. Under these contracts, Petron supplies the bunker fuel and diesel fuel oil requirements of selected NPC and PSALM plants, and NPC-supplied Independent Power Producers (IPP) plants.

As of September 30, 2012, the following are the fuel supply contracts granted to the Parent Company:

### NPC

| Bid Date          | Date of Award     | Contract Duration   | DFO* (in KL*) | IFO* (in KL) | DFO Total Contract Price | IFO Total Contract Price |
|-------------------|-------------------|---|---------------|--------------|--------------------------|--------------------------|
| December 29, 2011 | January 11, 2012  | NPC<br>(Calayan DP & others)<br>January- December 2012                  | 39,000        | 21,335       | 1,682                    | 758                      |
| December 29, 2011 | February 29, 2012 | NPC<br>(Calapan Modular and Jolo)<br>January-December 2012              | 23,708        |              | 1,032                    |                          |
| December 29, 2011 | July 4, 2012      | NPC<br>Repeat to Order of CY 2012<br>Contract<br>(July – December 2012) | 5,783         |              | 258                      |                          |

\* IFO = Industrial Fuel Oil \*  
DFO = Diesel Fuel Oil  
KL = Kilo Liters

### PSALM

| Bid Date          | Date of Award | Contract Duration  | DFO* (in KL*) | IFO* (in KL) | DFO Total Contract Price (Php) | IFO Total Contract Price (Php) |
|-------------------|---------------|--|---------------|--------------|--------------------------------|--------------------------------|
| February 21, 2012 | March 9, 2012 | PSALM- Power Barge 101<br>March- December 2012                           |               | 5,950        |                                | 205                            |
| February 21, 2012 | March 9, 2012 | PSALM- Power Barge 102<br>March- December 2012                           |               | 6,830        |                                | 236                            |
| February 21, 2012 | March 9, 2012 | PSALM- Power Barge 103<br>March- December 2012                           |               | 5,960        |                                | 208                            |
| February 21, 2012 | March 9, 2012 | PSALM- Power Barge 104<br>March- December 2012                           |               | 18,550       |                                | 643                            |
| February 21, 2012 | March 9, 2012 | PSALM- Southern Power<br>Philippines Corporation<br>March- December 2012 |               | 55,600       |                                | 1,907                          |
| May 28, 2012      | June 20, 2012 | PSALM- Naga TPP<br>Complex<br>June- December 2012                        | 570           |              | 25                             |                                |
| May 28, 2012      | June 20, 2012 | PSALM- Power Barge 101<br>June- December 2012                            | 360           |              | 16                             |                                |

| Bid Date     | Date of Award | Contract Duration   | DFO* (in KL*) | IFO* (in KL) | DFO Total Contract Price (Php) | IFO Total Contract Price (Php) |
|--------------|---------------|---|---------------|--------------|--------------------------------|--------------------------------|
| May 28, 2012 | June 20, 2012 | PSALM- Power Barge 102<br>June- December 2012                       | 480           |              | 21                             |                                |
| May 28, 2012 | June 20, 2012 | PSALM- Power Barge 103<br>June- December 2012                       | 480           |              | 22                             |                                |
| May 28, 2012 | June 20, 2012 | PSALM- Power Barge 104<br>June- December 2012                       | 830           |              | 36                             |                                |
| May 28, 2012 | June 20, 2012 | PSALM- Western Mindanao<br>Power Corporation<br>June- December 2012 | 60            |              | 3                              |                                |

\* IFO = Industrial Fuel Oil  
DFO = Diesel Fuel Oil  
KL = Kilo Liters

*Supply Agreement.* The Parent Company assigned all its rights and obligations to Petron Singapore Trading Pte. Ltd. (PSTPL) (as Assignee) to have a term contract to purchase the Parent Company's crude oil requirements from Saudi Arabian American Oil Company ("Saudi Aramco"), based on the latter's standard Far East selling prices. The contract is for a period of one year from October 28, 2008 to October 27, 2009 with automatic one-year extensions thereafter unless terminated at the option of either party, within 60 days written notice. Outstanding liabilities of the Parent Company for such purchases are shown as part of "Liabilities for Crude Oil and Petroleum Product Importation" account in the consolidated statements of financial position as of September 30, 2012 and December 31, 2011. The contract is extended until October 27, 2013.

## 6. Earnings Per Share

Basic and diluted earnings per share amounts for the nine months ended September 30, 2012 and 2011 are as follows:

|   | 2012           | 2011   |
|---|----------------|--------|
| Net income attributable to equity holders of the Parent Company         | <b>P886</b>    | P7,581 |
| Dividends on preferred shares for the period                            | <b>953</b>     | 714    |
| Net income (loss) attributable to common shareholders of Parent Company | <b>(P67)</b>   | P6,867 |
| Weighted average number of common shares outstanding (in millions)      | <b>9,375</b>   | 9,375  |
| Basic/diluted earnings (loss) per common share                          | <b>(P0.01)</b> | P0.73  |

As of September 30, 2012 and 2011, the Group has no dilutive debt or equity instruments.

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## 7. Dividends

On August 9, 2012, the Board of Directors (BOD) approved cash dividends of P2.382 per share to preferred shareholders for the fourth quarter of 2012 and the first quarter of 2013 with payment dates on December 5, 2012 and March 5, 2013, respectively.

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## 8. Commitments and Contingencies

### Unused Letters of Credit and Outstanding Standby Letters of Credit

Petron has unused letters of credit totaling approximately P45,100 and P25,452 as of September 30, 2012 and December 31, 2011, respectively.

### Tax Credit Certificates-Related Matters

In 1998, the Bureau of Internal Revenue (BIR) issued a deficiency excise tax assessment against the Parent Company relating to the Parent Company's use of P659 worth of Tax Credit Certificates (TCCs) to pay certain excise tax obligations from 1993 to 1997. The TCCs were transferred to the Parent Company by suppliers as payment for fuel purchases. The Parent Company contested the BIR's assessment before the Court of Tax Appeals (CTA). In July 1999, the CTA ruled that, as a fuel supplier of Board of Investments-(BOI) registered companies, the Parent Company was a qualified transferee of the TCCs and that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. On March 21, 2012, the Court of Appeals promulgated a decision in favor of the Parent Company and against the BIR affirming the ruling of the CTA striking down the assessment issued by the BIR for deficiency excise taxes in 1998 based on a finding by the BIR that the TCCs used by the Parent Company as payment were fraudulent. On April 19, 2012, a motion for reconsideration was filed by the BIR, which was denied by the CTA in its Resolution dated October 10, 2012.

In 2002, the BIR issued a P254 assessment against the Parent Company for deficiency excise taxes for the years 1995 to 1998 resulting from the cancellation by the Department of Finance (DOF) of tax debit memos, the related TCCs and their assignment to the Parent Company. The Parent Company contested the assessment before the CTA. On May 4, 2007, the CTA Second Division denied the Parent Company's petition, ordering the Parent Company to pay the BIR P601 representing the Parent Company's P254 unpaid deficiency excise taxes for the taxable years 1995 to 1998 and 25% late payment surcharge and 20% delinquency interest per annum computed from June 27, 2002. The Parent Company appealed the decision to the CTA *en banc*, which ruled in favor of the Parent Company, reversing the unfavorable decision of the CTA Second Division. The BIR contested the CTA *en banc* decision before the Supreme Court. On March 21, 2012, the Supreme Court promulgated a decision in favor of the Parent Company and against the BIR affirming the decision of the CTA *en banc* finding that the BIR had no legal basis to assess the excise taxes or any penalty surcharge or interest thereon as the Parent Company was an innocent transferee for value of the subject TCCs which had therefore properly filed its tax returns, and paid the appropriate taxes using such TCCs, for the years 1995 to 1998. A motion

was subsequently filed by the Office of the Solicitor General seeking for the reconsideration of the above decision. On July 11, 2012, the Supreme Court Second Division issued a resolution upholding its decision and denying the Office of the Solicitor General's motion for reconsideration with finality.

#### Pandacan Terminal Operations

In November 2001, the City of Manila enacted Ordinance No. 8027 (Ordinance 8027) reclassifying the areas occupied by the oil terminals of the Parent Company, Pilipinas Shell Petroleum Corporation (Shell) and Chevron Philippines Inc. (Chevron) from industrial to commercial. This reclassification made the operation of the oil terminals in Pandacan, Manila illegal. However, in June 2002, the Parent Company, together with Shell and Chevron, entered into an Memorandum of Understanding (MOU) with the City of Manila and the Department of Energy (DOE), agreeing to scale down operations, recognizing that this was a sensible and practical solution to reduce the economic impact of Ordinance 8027. In December 2002, in reaction to the MOU, the Social Justice Society (SJS) filed a petition with the Supreme Court against the Mayor of Manila asking that the latter be ordered to enforce Ordinance 8027. In April 2003, the Parent Company filed a petition with the Regional Trial Court (RTC) to annul Ordinance 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, Mayor of Manila ceased implementation of Ordinance 8027.

The City of Manila subsequently issued the Comprehensive Land Use Plan and Zoning Ordinance (Ordinance 8119), which applied to the entire City of Manila. Ordinance 8119 allowed the Parent Company (and other non-conforming establishments) a seven-year grace period to vacate. As a result of the passage of Ordinance 8119, which was thought to effectively repeal Ordinance 8027, in April 2007, the RTC dismissed the petition filed by the Parent Company questioning Ordinance 8027.

However, on March 7, 2007, in the case filed by SJS, the Supreme Court rendered a decision (March 7 Decision) directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, the Parent Company, together with Shell and Chevron, filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision. In the same year, the Parent Company also filed a petition before the RTC of Manila praying for the nullification of Ordinance 8119 on the grounds that the reclassification of the oil terminals was arbitrary, oppressive and confiscatory, and thus unconstitutional, and that the said Ordinance contravened the provisions of the Water Code of the Philippines (Presidential Decree No. 1067, the Water Code). On February 13, 2008, the Parent Company, Shell and Chevron were allowed by the Supreme Court to intervene in the case filed by SJS but their motions for reconsideration were denied. The Supreme Court declared Ordinance 8027 valid and dissolved all existing injunctions against the implementation of the Ordinance 8027.

In May 2009, Manila City Mayor Alfredo Lim approved Ordinance No. 8187 (Ordinance 8187), which amended Ordinance 8027 and Ordinance 8119 and permitted the continued operations of the oil terminals in Pandacan.



On August 31, 2012, the RTC of Manila ruled that Section 23 of Ordinance 8119 relating to the reclassification of subject oil terminals had already been repealed by Ordinance 8187; hence any issue pertaining thereto had become moot and academic. The RTC of Manila also declared Section 55 of Ordinance 8119 null and void for being in conflict with the Water Code. Nonetheless, the RTC upheld the validity of all other provisions of Ordinance 8119. On September 25, 2012, the Parent Company sought clarification and partial consideration of the August 31 decision and prayed for the nullification of the entire Ordinance 8119.

With regard to Ordinance 8187, petitions were filed before the Supreme Court, seeking for its nullification and the enjoinder of its implementation. The Parent Company filed a manifestation on November 30, 2010 informing the Supreme Court that, without prejudice to its position in the cases, it had decided to cease operation of its petroleum product storage facilities in Pandacan within 5 years or not later than January 2016 due to the many unfounded environmental issues being raised that tarnish the image of the Parent Company and the various amendments being made to the zoning ordinances of the City of Manila when the composition of the local government changes that prevented the Parent Company from making long-term plans. In a letter dated July 6, 2012 (with copies to the offices of the Vice Mayor and the City Council of Manila), the Parent Company reiterated its commitment to cease the operation of its petroleum product storage facilities and transfer them to another location by January 2016.

#### Guimaras Oil Spill Incident

On August 11, 2006, MT Solar I, a third party vessel contracted by the Parent Company to transport approximately two million liters of industrial fuel oil, sank 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the Philippine Department of Justice (DOJ) and the Special Board of Marine Inquiry (SBMI), both agencies found the owners of MT Solar I liable. The DOJ found the Parent Company not criminally liable, but the SBMI found the Parent Company to have overloaded the vessel. The Parent Company has appealed the findings of the SBMI to the Philippine Department of Transportation and Communication (DOTC) and is awaiting its resolution. The Parent Company believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as the Parent Company, which are charterers.

In 2009, complaints for violation of the Philippine Clean Water Act of 2004 (Republic Act No. 9275, the Clean Water Act) and homicide and less serious physical injuries were filed against the Parent Company. Complainants claim that their exposure to and close contact with waters along the shoreline and mangroves affected by the oil spill has caused them major health problems. On February 13, 2012, an Information was filed against the owner and the Captain of MT Solar 1 and Messrs. Khalid Al-Faddagh and Nicasio Alcantara, former President and Chairman of the Parent Company, respectively, for violation of the Clean Water Act. On March 28, 2012, the court dismissed the information for lack of probable cause and for lack of jurisdiction over the offense charged. The Provincial Prosecutor and the private prosecutor filed a motion for reconsideration of this March 28 Order of the court. On August 13, 2012, the court issued an order denying the said motion for reconsideration.

Other complaints for non-payment of compensation for the clean-up operations during the oil spill were filed by a total of 1,063 plaintiffs who allegedly did not receive any payment of their claims for damages arising from the oil spill. The total claims for both cases amount to P292. At present the cases are under mediation for possible amicable settlement among the parties.

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## 9. Financial Risk Management Objectives and Policies

The Group's principal financial instruments include cash and cash equivalents, debt and equity securities, bank loans and derivative instruments. The main purpose of bank loans is to finance working capital relating to importation of crude and petroleum products, as well as to partly fund capital expenditures. The Group has other financial assets and liabilities such as trade and other receivables and trade and other payables, which are generated directly from its operations.

It is the Group's policy not to enter into derivative transactions for speculative purposes. The Group uses hedging instruments to protect its margin on its products from potential price volatility of crude oil and products. It also enters into short-term forward currency contracts to hedge its currency exposure on crude oil importations.

The main risks arising from the Group's financial instruments are foreign exchange risk, interest rate risk, credit risk, liquidity risk and commodity price risk. The BOD regularly reviews and approves the policies for managing these financial risks. Details of each of these risks are discussed below, together with the related risk management structure.

### Risk Management Structure

The Group follows an enterprise-wide risk management framework for identifying, assessing and addressing the risk factors that affect or may affect its businesses.

The Group's risk management process is a bottom-up approach, with each risk owner mandated to conduct regular assessment of its risk profile and formulate action plans for managing identified risks. As the Group's operation is an integrated value chain, risks emanate from every process, while some can cut across groups. The results of these activities flow up to the Management Committee and, eventually, the BOD through the Group's annual business planning process.

Oversight and technical assistance is likewise provided by corporate units and committees with special duties. These groups and their functions are:

1. The Risk and Insurance Management Group, which is mandated with the overall coordination and development of the enterprise-wide risk management process.
2. The Financial Risk Management Unit of the Treasurer's Department, which is in charge of foreign exchange hedging transactions.
3. The Transaction Management Unit of Controllers Department, which provides backroom support for all hedging transactions.

4. The Corporate Technical & Engineering Services Group, which oversees strict adherence to safety and environmental mandates across all facilities.
5. The Internal Audit Department, which has been tasked with the implementation of a risk-based auditing.
6. PSTPL executes the hedging transactions involving crude and product imports on behalf of the Group.

The BOD also created separate board-level entities with explicit authority and responsibility in managing and monitoring risks, as follows:

- a. The Audit Committee, which ensures the integrity of internal control activities throughout the Group. It develops, oversees, checks and pre-approves financial management functions and systems in the areas of credit, market, liquidity, operational, legal and other risks of the Group, and crisis management. The Internal Audit Department and the External Auditor directly report to the Audit Committee regarding the direction, scope and coordination of audit and any related activities.
- b. The Compliance Officer, who is a senior officer of the Parent Company reports to the BOD through the Audit Committee. He monitors compliance with the provisions and requirements of the Corporate Governance Manual, determines any possible violations and recommends corresponding penalties, subject to review and approval of the BOD. The Compliance Officer identifies and monitors compliance risk. Lastly, the Compliance Officer represents the Group before the SEC regarding matters involving compliance with the Corporate Governance Manual.

#### *Foreign Currency Risk*

The Group's functional currency is the Philippine peso, which is the denomination of the bulk of the Group's revenues. The Group's exposures to foreign exchange risk arise mainly from United States (US) dollar-denominated sales as well as purchases principally of crude oil and petroleum products. As a result of this, the Group maintains a level of US dollar-denominated assets and liabilities during the period. Foreign exchange risk occurs due to differences in the levels of US dollar-denominated assets and liabilities.

In addition, starting March 31, 2012, the Group's exposure to foreign exchange risks also arise from US dollar-denominated sales and purchases, principally of crude oil and petroleum products, of Petron Oil & Gas International Sdn Bhd (POGI) whose transactions are in Malaysian ringgit, which are subsequently converted into US dollar before ultimately translated to equivalent Philippine peso amount using applicable rates for the purpose of consolidation.

The Group pursues a policy of hedging foreign exchange risk by purchasing currency forwards or by substituting US dollar-denominated liabilities with peso-based debt. The natural hedge provided by US dollar-denominated assets is also factored in hedging decisions. As a matter of policy, currency hedging is limited to the extent of 100% of the underlying exposure.

The Group is allowed to engage in active risk management strategies for a portion of its foreign exchange risk exposure. Loss limits are in place, monitored daily and regularly reviewed by management.

Information on the Group's US dollar-denominated financial assets and liabilities and their Philippine peso equivalents as of September 30, 2012 and December 31, 2011 is as follows:

|  | September 30, 2012 |                 | December 31, 2011 |                 |
|--|--------------------|-----------------|-------------------|-----------------|
|  | US Dollar          | Peso Equivalent | US Dollar         | Peso Equivalent |
| <b>Assets</b>  |                    |                 |                   |                 |
| Cash and cash equivalents                                    | 262                | 10,925          | 338               | 14,818          |
| Trade and other receivables                                  | 1,041              | 43,410          | 343               | 15,037          |
| Other assets   | 65                 | 2,711           | 29                | 1,271           |
|  | <b>1,368</b>       | <b>57,046</b>   | 710               | 31,126          |
| <b>Liabilities</b>   |                    |                 |                   |                 |
| Short-term loans   | 520                | 21,684          | -                 | -               |
| Liabilities for crude oil and petroleum product importation  | 1,288              | 53,710          | 509               | 22,314          |
| Long-term debt (including current maturities)                | 300                | 12,510          | 356               | 15,607          |
| Other liabilities  | 127                | 5,296           | 7                 | 307             |
|  | <b>2,235</b>       | <b>93,200</b>   | 872               | 38,228          |
| <b>Net foreign currency-denominated monetary liabilities</b> | <b>(867)</b>       | <b>(36,154)</b> | (162)             | (7,102)         |

The Group reported net foreign exchange gains (losses) amounting to P757 and (P17) for the period ending September 30, 2012 and September 30, 2011, respectively, with the translation of its foreign currency-denominated assets and liabilities. These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

|                    | Peso to US Dollar |
|--------------------|-------------------|
| September 30, 2011 | 43.72             |
| December 31, 2011  | 43.84             |
| September 30, 2012 | 41.70             |

The management of foreign currency risk is also supplemented by monitoring the sensitivity of financial instruments to various foreign currency exchange rate scenarios. Foreign exchange movements affect reported equity through the retained earnings arising from increases or decreases in unrealized and realized foreign exchange gains or losses.

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar exchange rate, with all other variables held constant, of profit before tax and equity as of September 30, 2012 and December 31, 2011:

|   | P1 decrease in the US\$<br>exchange rate |                     | P1 increase in the US\$<br>exchange rate |                     |
|---|--|---------------------|--|---------------------|
|   | Effect on<br>Income before<br>Income Tax | Effect on<br>Equity | Effect on<br>Income before<br>Income Tax | Effect on<br>Equity |
| <b>September 30, 2012</b>   |  |                     |  |                     |
| Cash and cash equivalents   | (125)                                    | (225)               | 125                                      | 225                 |
| Trade and other receivables                                       | (61)                                     | (1,023)             | 61                                       | 1,023               |
| Other assets  | (42)                                     | (53)                | 42                                       | 53                  |
|   | (228)                                    | (1,301)             | 228                                      | 1,301               |
| Short-term loans  | -  | 520                 | -  | (520)               |
| Liabilities for crude oil and<br>petroleum product<br>importation | 367                                      | 1,178               | (367)                                    | (1,178)             |
| Long-term debt (including<br>current maturities)                  | 300                                      | 210                 | (300)                                    | (210)               |
| Other liabilities   | 91                                       | 99                  | (91)                                     | (99)                |
|   | 758                                      | 2,007               | (758)                                    | (2,007)             |
|   | 530                                      | 706                 | (530)                                    | (706)               |

|   | P1 decrease in the US\$<br>exchange rate |                     | P1 increase in the US\$<br>exchange rate |                     |
|---|--|---------------------|--|---------------------|
|   | Effect on<br>Income before<br>Income Tax | Effect on<br>Equity | Effect on<br>Income before<br>Income Tax | Effect on<br>Equity |
| <b>December 31, 2011</b>  |  |                     |  |                     |
| Cash and cash<br>equivalents                                      | (P319)                                   | (P243)              | P319                                     | P243                |
| Trade and other<br>receivables                                    | (103)                                    | (312)               | 103                                      | 312                 |
| Other assets  | (13)                                     | (25)                | 13                                       | 25                  |
|   | (435)                                    | (580)               | 435                                      | 580                 |
| Liabilities for crude oil<br>and petroleum product<br>importation | 275                                      | 426                 | (275)                                    | (426)               |
| Long-term debt<br>(including current<br>maturities)               | 356                                      | 249                 | (356)                                    | (249)               |
| Other liabilities   | 5  | 6                   | (5)                                      | (6)                 |
|   | 636                                      | 681                 | (636)                                    | (681)               |
|   | P201                                     | P101                | (P201)                                   | (P101)              |

Exposures to foreign exchange rates vary during the year depending on the volume of foreign currency denominated transactions. Nonetheless, the analysis above is considered to be representative of the Group's currency risk.

#### *Interest Rate Risk*

Interest rate risk is the risk that future cash flows from a financial instrument (cash flow interest rate risk) or its fair value (fair value interest rate risk) will fluctuate because of changes in market interest rates. The Group's exposure to changes in interest rates relates mainly to the Group's long-term borrowings and investment securities. Investments acquired or borrowings issued at fixed rates expose the Group to fair value interest rate risk. On the other hand, investment securities or borrowings issued at variable rates expose the Group to cash flow interest rate risk.

The Group manages its interest costs by using an optimal combination of fixed and variable rate debt instruments. Management is responsible for monitoring the prevailing market-based interest rates and ensures that the mark-up rates levied on its borrowings are most favorable and benchmarked against the interest rates charged by other creditor banks.

On the other hand, the Group's investment policy is to maintain an adequate yield to match or reduce the net interest cost from its borrowings pending the deployment of funds to their intended use in the Group's operations and working capital management. However, the Group invests only in high-quality securities while maintaining the necessary diversification to avoid concentration risk.

In managing interest rate risk, the Group aims to reduce the impact of short-term volatility on the Group earnings. Over the longer term, however, permanent changes in interest rates would have an impact on profit or loss.

The management of interest rate risk is also supplemented by monitoring the sensitivity of the Group's financial instruments to various standard and non-standard interest rate scenarios. Interest rate movements affect reported equity through the retained earnings arising from increases or decreases in interest income or interest expense as well as fair value changes reported in profit or loss, if any.

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P125 and P168 in the period ending September 30, 2012 and December 31, 2011, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. There is no impact on the Group's other income.

### Interest Rate Risk Table

As at September 30, 2012 and December 31, 2011, the terms and maturity profile of the interest-bearing financial instruments, together with its gross amounts, are shown in the following tables:

| September 30, 2012                         | <1 year     | 1-<2 years  | 2-<3 years                  | 3-<4 years                  | 4-<5 years                  | >5 years    | Total   |
|--|-------------|-------------|-----------------------------|-----------------------------|-----------------------------|-------------|---------|
| <b>Fixed rate</b>                          |             |             |                             |                             |                             |             |         |
| Philippine peso denominated                | P84         | P5,284      | P84                         | P4,548                      | P36                         | P23,420     | P33,456 |
| Interest rate                              | 6.3% - 9.3% | 6.3% - 9.3% | 6.3% - 9.3%                 | 6.3% - 9.3%                 | 6.3% - 7.2%                 | 6.3% - 7.2% |         |
| <b>US\$ denominated (expressed in Php)</b> | -           | -           | 3,932                       | 5,719                       | 2,859                       | -           | 12,510  |
| Interest rate*                             |             |             | 1, 3, 6 mos. Libor + margin | 1, 3, 6 mos. Libor + margin | 1, 3, 6 mos. Libor + margin |             |         |
|  | P84         | P5,284      | P4,016                      | P10,267                     | P2,895                      | P23,420     | P45,966 |

\*The group reprices every 3 months but has been given an option to reprice every 1 or 6 months.

| December 31, 2011                          | <1 year  | 1-<2 years                                       | 2-<3 years                 | 3-<4 years                 | 4-<5 years                 | >5 years    | Total   |
|--|--|--|----------------------------|----------------------------|----------------------------|-------------|---------|
| <b>Fixed rate</b>                          |  |  |                            |                            |                            |             |         |
| Philippine peso denominated                | P238   | P84  | P5,284                     | P84                        | P4,548                     | P23,420     | P33,658 |
| Interest rate                              | 6.3% - 9.3%                                      | 6.3% - 9.3%                                      | 6.3% - 9.3%                | 6.3% - 9.3%                | 6.3% - 9.3%                | 6.3% - 7.2% |         |
| <b>Floating rate</b>                       |  |  |                            |                            |                            |             |         |
| Philippine peso denominated                | 600  | 600  | -                          | -                          | -                          | -           | 1,200   |
| Interest rate                              | net 1M SDA + margin, 3-mo. Mart1/ PDSTF + margin | net 1M SDA + margin, 3-mo. Mart1/ PDSTF + margin |                            |                            |                            |             |         |
| <b>US\$ denominated (expressed in Php)</b> | 3,458  | 3,960  | 4,461                      | 2,731                      | 1,002                      | -           | 15,612  |
| Interest rate*                             | 1,3, 6 mos. Libor + margin                       | 1,3, 6 mos. Libor + margin                       | 1,3, 6 mos. Libor + margin | 1,3, 6 mos. Libor + margin | 1,3, 6 mos. Libor + margin |             |         |
|  | P4,296   | P4,644   | P9,745                     | P2,815                     | P5,550                     | P23,420     | P50,470 |

\*The group reprices every 3 months but has been given an option to reprice every 1 or 6 months.

### Credit Risk

Credit Risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. In effectively managing credit risk, the Group regulates and extends credit only to qualified and credit-worthy customers and counterparties, consistent with established Group credit policies, guidelines and credit verification procedures. Requests for credit facilities from trade customers undergo stages of review by the Sales and Finance Divisions. Approvals, which are based on amounts of credit lines requested, are vested among line managers and top management that includes the President and the Chairman. Generally, the maximum credit risk exposure of financial assets is the total carrying amount of the

financial assets as shown on the face of the consolidated statements of financial position or in the notes to the consolidated financial statements, as summarized below:

|                                   | September 30, 2012 | December 31, 2011 |
|-----------------------------------|--------------------|-------------------|
| Cash in bank and cash equivalents | P17,200            | P19,528           |
| Derivative assets                 | 39                 | 43                |
| Trade and other receivables-net   | 43,972             | 26,605            |
| Due from related parties          | 11,426             | 23,787            |
| Long-term receivables             | 390                | 88                |
|                                   | <b>P73,027</b>     | <b>P70,051</b>    |

The credit risk for cash in bank and cash equivalents and derivative financial instruments is considered negligible, since the counterparties are reputable entities with high quality external credit ratings. The credit quality of these financial assets is considered to be high grade.

In monitoring trade receivables and credit lines, the Group maintains up-to-date records where daily sales and collection transactions of all customers are recorded in real-time and month-end statements of accounts are forwarded to customers as collection medium. Finance Division's Credit Department regularly reports to management trade receivables balances (monthly) and credit utilization efficiency (semi-annually).

*Collaterals.* To the extent practicable, the Group also requires collateral as security for a credit facility to mitigate risk in trade receivables. Among the collaterals held are letters of credit, bank guarantees, real estate mortgages, and cash bonds valued at P3,554 and P3,925 as of September 30, 2012 and December 31, 2011, respectively. These securities may only be called on or applied upon default of customers.

*Credit Risk Concentration.* The Group's exposure to credit risk arises from default of counterparty. Generally, the maximum credit risk exposure of trade and other receivables is its carrying amount without considering collaterals or credit enhancements, if any. The Group has no significant concentration of credit risk since the Group deals with a large number of homogenous trade customers. The Group does not execute any guarantee in favor of any counterparty.

*Credit Quality.* In monitoring and controlling credit extended to counterparty, the Group adopts a comprehensive credit rating system based on financial and non-financial assessments of its customers. Financial factors being considered comprised of the financial standing of the customer while the non-financial aspects include but are not limited to the assessment of the customer's nature of the business, management profile, industry background, payment habit and both present and potential business dealings with the Group.

Class A "High Grade" are accounts with strong financial capacity and business performance and with the lowest default risk.



Class B “Moderate Grade” refers to accounts of satisfactory financial capability and credit standing but with some elements of risks where certain measure of control is necessary in order to mitigate risk of default.

Class C “Low Grade” are accounts with high probability of delinquency and default.

#### *Liquidity Risk*

Liquidity risk pertains to the risk that the Group will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

The Group’s objectives in managing its liquidity risk are as follows: a) to ensure that adequate funding is available at all times; b) to meet commitments as they arise without incurring unnecessary costs; c) to be able to access funding when needed at the least possible cost; and d) to maintain an adequate time spread of refinancing maturities.

The Group constantly monitors and manages its liquidity position, liquidity gaps or surplus on a daily basis. A committed stand-by credit facility from several local banks is also available to ensure availability of funds when necessary. The Group also uses derivative instruments such as forwards and swaps to manage liquidity.

The table below summarizes the maturity profile of the Group’s financial assets and financial liabilities based on contractual undiscounted payments used for liquidity management as of September 30, 2012 and December 31, 2011.

| <b>September 30, 2012</b>                                       | <b>Carrying Amount</b> | <b>Contractual Cash Flow</b> | <b>1year or less</b> | <b>&gt;1 year - 2 years</b> | <b>&gt;2 year - 5 years</b> | <b>Over 5 years</b> |
|---|------------------------|------------------------------|----------------------|-----------------------------|-----------------------------|---------------------|
| <b>Financial assets</b>   |                        |                              |                      |                             |                             |                     |
| Cash and cash equivalents                                       | P21,627                | P21,627                      | P21,627              | P-                          | P-                          | P-                  |
| Trade and other receivables                                     | 43,972                 | 43,972                       | 43,972               | -                           | -                           | -                   |
| Due from related parties  | 11,426                 | 11,815                       | 611                  | 11,005                      | 199                         | -                   |
| Derivative assets   | 39                     | 39                           | 39                   | -                           | -                           | -                   |
| Financial assets at FVPL  | 119                    | 119                          | 119                  | -                           | -                           | -                   |
| AFS financial assets  | 927                    | 951                          | 118                  | 179                         | 654                         | -                   |
| Long-term receivables   | 390                    | 403                          | 35                   | 57                          | 92                          | 219                 |
| <b>Financial liabilities</b>                                    |                        |                              |                      |                             |                             |                     |
| Short-term loans  | 74,293                 | 74,715                       | 74,715               | -                           | -                           | -                   |
| Liabilities for crude oil and petroleum product importation     | 44,435                 | 44,435                       | 44,435               | -                           | -                           | -                   |
| Accounts payable and accrued expenses (excluding taxes payable) | 9,343                  | 9,343                        | 9,343                | -                           | -                           | -                   |
| (Forward)   |                        |                              |                      |                             |                             |                     |

| <b>September 30, 2012</b>                     | <b>Carrying Amount</b> | <b>Contractual Cash Flow</b> | <b>1 year or less</b> | <b>&gt;1 year - 2 years</b> | <b>&gt;2 year - 5 years</b> | <b>Over 5 years</b> |
|---|------------------------|------------------------------|-----------------------|-----------------------------|-----------------------------|---------------------|
| Derivative liabilities                        | 81                     | 81                           | 81                    | -                           | -                           | -                   |
| Long-term debt (including current maturities) | 45,329                 | 60,887                       | 3,283                 | 8,512                       | 24,465                      | 24,627              |
| Cash bonds                                    | 344                    | 348                          | 291                   | 8                           | 9                           | 40                  |
| Cylinder deposits                             | 265                    | 265                          | -                     | -                           | -                           | 265                 |
| Other noncurrent liabilities                  | 47                     | 47                           | -                     | -                           | 25                          | 22                  |

| <b>December 31, 2011</b>  | <b>Carrying Amount</b> | <b>Contractual Cash Flow</b> | <b>1 year or less</b> | <b>&gt;1 year - 2 years</b> | <b>&gt;2 year - 5 years</b> | <b>Over 5 Years</b> |
|---|------------------------|------------------------------|-----------------------|-----------------------------|-----------------------------|---------------------|
| <b>Financial assets</b>   |                        |                              |                       |                             |                             |                     |
| Cash and cash equivalents                                       | P23,823                | P23,823                      | P23,823               | P-                          | P-                          | P-                  |
| Trade and other receivables                                     | 26,605                 | 26,610                       | 26,610                | -                           | -                           | -                   |
| Due from related parties  | 23,787                 | 24,337                       | 1,610                 | 22,346                      | 381                         | -                   |
| Derivative assets   | 43                     | 43                           | 43                    | -                           | -                           | -                   |
| Financial assets at FVPL  | 194                    | 194                          | 194                   | -                           | -                           | -                   |
| AFS financial assets  | 1,036                  | 1,107                        | 93                    | 117                         | 897                         | -                   |
| Long-term receivables   | 88                     | 99                           | 7                     | 25                          | 39                          | 28                  |
| <b>Financial liabilities</b>                                    |                        |                              |                       |                             |                             |                     |
| Short-term loans  | 40,593                 | 40,877                       | 40,877                | -                           | -                           | -                   |
| Liabilities for crude oil and petroleum product importation     | 13,842                 | 13,842                       | 13,842                | -                           | -                           | -                   |
| Accounts payable and accrued expenses (excluding taxes payable) | 6,600                  | 6,600                        | 6,600                 | -                           | -                           | -                   |
| Derivative liabilities  | 55                     | 55                           | 55                    | -                           | -                           | -                   |
| Long-term debt (including current maturities)                   | 49,868                 | 67,242                       | 7,621                 | 9,308                       | 24,076                      | 26,237              |
| Cash bonds  | 303                    | 312                          | 257                   | 11                          | 15                          | 29                  |
| Cylinder deposits   | 383                    | 383                          | -                     | -                           | -                           | 383                 |
| Other noncurrent liabilities                                    | 54                     | 54                           | -                     | 1                           | 32                          | 21                  |

### *Commodity Price Risk*

Commodity price risk is the risk that future cash flows from a financial instrument will fluctuate because of changes in market prices.

To minimize the Group's risk of potential losses due to volatility of international crude and product prices, the Group implemented commodity hedging for crude and petroleum products. The hedges are intended to protect crude inventories from downward price risk and margins of MOPS (Mean of Platts of Singapore)-based sales. Hedging policy (including the use of commodity price swaps, buying of put options, collars and 3-way options) developed by the Commodity Risk Management Committee is in place. Decisions are guided by the conditions set and approved by the Group's management.

#### *Other Market Price Risk*

The Group's market price risk arises from its investments carried at fair value (FVPL and AFS financial assets). The Group manages its risk arising from changes in market price by monitoring the changes in the market price of the investments.

#### *Capital Management*

The Group's capital management policies and programs aim to provide an optimal capital structure that would ensure the Group's ability to continue as a going concern while at the same time provide adequate returns to the shareholders. As such, it considers the best trade-off between risks associated with debt financing and relatively higher cost of equity funds. Likewise, compliance with the debt to equity ratio covenant of bank loans has to be ensured.

An enterprise resource planning system is used to monitor and forecast the Group's overall financial position. The Group regularly updates its near-term and long-term financial projections to consider the latest available market data in order to preserve the desired capital structure. The Group may adjust the amount of dividends paid to shareholders, issue new shares as well as increase or decrease assets and/or liabilities, depending on the prevailing internal and external business conditions.

The Group monitors capital via carrying amount of equity as stated in the consolidated statements of financial position. The Group's capital for the covered reporting period is summarized in the table below:

|                       | <b>September 30, 2012</b> | December 31, 2011 |
|-----------------------|---------------------------|-------------------|
| Total assets          | <b>P255,445</b>           | P175,795          |
| Total liabilities     | <b>180,249</b>            | 116,108           |
| Total equity          | <b>75,196</b>             | 59,687            |
| Asset to equity ratio | <b>3.4:1</b>              | 2.9:1             |
| Debt to equity ratio  | <b>2.4:1</b>              | 1.9:1             |

There were no changes in the Group's approach to capital management during the period.

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## **10. Financial Assets and Financial Liabilities**

*Date of Recognition.* The Group recognizes a financial asset or a financial liability in the consolidated statements of financial position when it becomes a party to the contractual provisions of the instrument. In the case of a regular way purchase or sale of financial assets, recognition is done using settlement date accounting.

*Initial Recognition of Financial Instruments.* Financial instruments are recognized initially at fair value of the consideration given (in case of an asset) or received (in case of a liability). The initial measurement of financial instruments, except for those designated at fair value through profit or loss (FVPL), includes transaction costs.

The Group classifies its financial assets in the following categories: held-to-maturity (HTM) investments, available for sale (AFS) financial assets, financial assets at FVPL and loans and receivables. The Group classifies its financial liabilities as either financial liabilities at FVPL or other financial liabilities. The classification depends on the purpose for which the investments are acquired and whether they are quoted in an active market. Management determines the classification of its financial assets and financial liabilities at initial recognition and, where allowed and appropriate, re-evaluates such designation at every reporting date.

*Determination of Fair Value.* The fair value for financial instruments traded in active markets at the reporting date is based on their quoted market price or dealer price quotations (bid price for long positions and ask price for short positions), without any deduction for transaction costs. When current bid and ask prices are not available, the price of the most recent transaction provides evidence of the current fair value as long as there is no significant change in economic circumstances since the time of the transaction.

For all other financial instruments not listed in an active market, the fair value is determined by using appropriate valuation techniques. Valuation techniques include the discounted cash flow method, comparison to similar instruments for which market observable prices exist, options pricing models and other relevant valuation models.

*'Day 1' Profit.* Where the transaction price in a non-active market is different from the fair value of the other observable current market transactions in the same instrument or based on a valuation technique whose variables include only data from observable market, the Group recognizes the difference between the transaction price and fair value (a 'Day 1' profit) in profit or loss unless it qualifies for recognition as some other type of asset. In cases where transaction price is based on data which are not observable, the difference between the transaction price and model value is only recognized in profit or loss when the inputs become observable or when the instrument is derecognized. For each transaction, the Group determines the appropriate method of recognizing the 'Day 1' profit amount.

#### Financial Assets

*Financial Assets at FVPL.* A financial asset is classified at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at FVPL if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

Financial assets are classified as held for trading if they are acquired for the purpose of selling in the near term.

Financial assets may be designated by management at initial recognition as at FVPL, when any of the following criteria is met:

- the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or recognizing gains or losses on a different basis;
- the assets are part of a group of financial assets which are managed and their performances are evaluated on a fair value basis, in accordance with a documented risk management or investment strategy; or
- the financial instrument contains an embedded derivative, unless the embedded derivative does not significantly modify the cash flows or it is clear, with little or no analysis, that it would not be separately recognized.

The Group uses commodity price swaps to protect its margin on petroleum products from potential price volatility of international crude and product prices. It also enters into short-term forward currency contracts to hedge its currency exposure on crude oil importations. In addition, the Company has identified and bifurcated embedded foreign currency derivatives from certain non-financial contracts.

Derivative instruments are initially recognized at fair value on the date in which a derivative transaction is entered into or bifurcated and are subsequently re-measured at fair value. Derivatives are presented in the separate statement of financial position as assets when the fair value is positive and as liabilities when the fair value is negative. Gains and losses from changes in fair value of these derivatives are recognized under the caption marked-to-market gain (losses) included as part of "Other Income (Expenses)" in the consolidated statements of income.

The fair values of freestanding and bifurcated forward currency transactions are calculated by reference to current exchange rates for contracts with similar maturity profiles. The fair values of commodity swaps are determined based on quotes obtained from counterparty banks.

The Group's financial assets at FVPL and derivative assets are included in this category.

The carrying values of financial assets under this category amounted to P158 and P237 as of September 30, 2012 and December 31, 2011, respectively.

*Loans and Receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments and maturities that are not quoted in an active market. They are not entered into with the intention of immediate or short-term resale and are not designated as AFS financial assets or financial assets at FVPL.

Subsequent to initial measurement, loans and receivables are carried at amortized cost using the effective interest rate method, less any impairment in value. Any interest earned on loans and receivables shall be recognized as part of "Interest income" in consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" in the consolidated statements of

income. Gains or losses are recognized in profit or loss when loans and receivables are derecognized or impaired, as well as through the amortization process.

Cash includes cash on hand and in banks which are stated at face value. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash which are subject to an insignificant risk of changes in value.

The Group's cash and cash equivalents, trade and other receivables, due from related parties and long-term receivables are included in this category.

The combined carrying values of financial assets under this category amounted to P77,415 and P74,303 as of September 30, 2012 and December 31, 2011, respectively.

*HTM Investments.* HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Group's management has the positive intention and ability to hold to maturity. Where the Group sells other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS financial assets. After initial measurement, these investments are measured at amortized cost using the effective interest rate method, less impairment in value. Any interest earned on the HTM investments shall be recognized as part of "Interest income" in the consolidated statements of income on an accrual basis. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are integral part of the effective interest rate. The periodic amortization is also included as part of "Interest income" in the consolidated statements of income. Gains or losses are recognized in profit or loss when the HTM investments are derecognized or impaired, as well as through the amortization process.

As of September 30, 2012 and December 31, 2011, the Group has no investments accounted for under this category.

*AFS Financial Assets.* AFS financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other financial asset categories. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on AFS debt instruments, are recognized in other comprehensive income and presented in the "Other reserves" in equity. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS investment securities, is reported as part of "Interest income" in the consolidated statements of income. The unrealized gains and losses arising from the changes in fair value of AFS financial assets, net of tax, are excluded from profit and loss and are recognized as other comprehensive income reported in the consolidated statements of comprehensive income and in the consolidated statements of changes in equity under "Other Reserves" account. Any interest earned on AFS debt securities shall be recognized as part of "Interest income" in the consolidated statements of income on an accrual basis. Dividends earned on holding AFS equity securities are recognized as "Dividend income" when the right of collection has been established. When individual AFS financial assets are either derecognized or impaired, the related accumulated unrealized gains or losses previously reported in equity are transferred to and recognized in profit or loss.

Where the Group holds more than one investment in the same security, these are deemed to be disposed on a first-in, first-out basis. Interest and dividends earned on holding AFS financial assets are recognized in “Other Income” account in the consolidated statements of income when the right to receive payment has been established. The losses arising from impairment of such investments are recognized as impairment losses in profit or loss.

AFS financial assets also include unquoted equity instruments with fair values which cannot be reliably determined. These instruments are carried at cost less impairment in value, if any. The Group’s investments in equity and debt securities included under “AFS” account are classified under this category.

The carrying values of financial assets under this category amounted to P927 and P1,036 as of September 30, 2012 and December 31, 2011, respectively.

#### Financial Liabilities

*Financial Liabilities at FVPL.* Financial liabilities are classified under this category through the fair value option. Derivative instruments (including embedded derivatives) with negative fair values, except those covered by hedge accounting relationships, are also classified under this category.

The Group carries financial liabilities at FVPL using their fair values and reports fair value changes in the consolidated statements of income.

The Group’s derivative liabilities are classified under this category.

The carrying values of financial liabilities under this category amounted to P81 and P55 as of September 30, 2012 and December 31, 2011, respectively.

*Other Financial Liabilities.* This category pertains to financial liabilities that are not designated or classified as at FVPL. After initial measurement, other financial liabilities are carried at amortized cost using the effective interest rate method. Amortized cost is calculated by taking into account any premium or discount and any directly attributable transaction costs that are considered an integral part of the effective interest rate of the liability.

Included in this category are the Group’s liabilities arising from its short term loans, liabilities for crude oil and petroleum product importation, trade and other payables, long-term debt, cash bonds, cylinder deposits and other non-current liabilities.

The combined carrying values of financial liabilities under this category amounted to P174,056 and P111,643 as of September 30, 2012 and December 31, 2011, respectively.

#### Debt Issue Costs

Debt issue costs are considered as an adjustment to the effective yield of the related debt and are deferred and amortized using the effective interest method. When a loan is paid, the related unamortized debt issue costs at the date of repayment are recognized in profit or loss.

### Embedded Derivatives

The Group assesses whether embedded derivatives are required to be separated from host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at FVPL. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

### Derecognition of Financial Assets and Financial Liabilities

*Financial Assets.* A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- the right to receive cash flows from the asset have expired;
- the Group retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a “pass-through” arrangement; or
- the Group has transferred its rights to receive cash flows from the asset and either: (a) has transferred substantially all the risks and rewards of the asset; or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

When the Group has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognized to the extent of the Group’s continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Group could be required to repay.

*Financial Liabilities.* A financial liability is derecognized when the obligation under the liability is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognized in profit or loss.

### Impairment of Financial Assets

The Group assesses at reporting date whether a financial asset or group of financial assets is impaired.



A financial asset or a group of financial assets is deemed to be impaired if, and only if, there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (an incurred loss event) and that loss event has an impact on the estimated future cash flows of the financial asset or the group of financial assets that can be reliably estimated.

*Assets Carried at Amortized Cost.* For assets carried at amortized cost such as loans and receivables, the Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, or collectively for financial assets that are not individually significant. If no objective evidence of impairment has been identified for a particular financial asset that was individually assessed, the Group includes the asset as part of a group of financial assets pooled according to their credit risk characteristics and collectively assesses the group for impairment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognized are not included in the collective impairment assessment.

Evidence of impairment for specific impairment purposes may include indications that the borrower or a group of borrowers is experiencing financial difficulty, default or delinquency in principal or interest payments, or may enter into bankruptcy or other form of financial reorganization intended to alleviate the financial condition of the borrower. For collective impairment purposes, evidence of impairment may include observable data on existing economic conditions or industry-wide developments indicating that there is a measurable decrease in the estimated future cash flows of the related assets.

If there is objective evidence of impairment, the amount of loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). Time value is generally not considered when the effect of discounting the cash flows is not material. If a loan or receivable has a variable rate, the discount rate for measuring any impairment loss is the current effective interest rate, adjusted for the original credit risk premium. For collective impairment purposes, impairment loss is computed based on their respective default and historical loss experience.

The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The impairment loss for the period shall be recognized in profit or loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed. Any subsequent reversal of an impairment loss is recognized in profit or loss, to the extent that the carrying amount of the asset does not exceed its amortized cost at the reversal date.

*AFS Financial Assets.* If an AFS financial asset is impaired, an amount comprising the difference between the cost (net of any principal payment and amortization) and its current fair value, less any impairment loss on that financial asset previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as AFS financial assets are not recognized in profit or loss. Reversals of impairment losses on debt instruments are

recognized in profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in profit or loss.

In the case of an unquoted equity instrument or of a derivative asset linked to and must be settled by delivery of an unquoted equity instrument for which its fair value cannot be reliably measured, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows from the asset discounted using its historical effective rate of return on the asset.

#### Classification of Financial Instruments Between Debt and Equity

From the perspective of the issuer, a financial instrument is classified as debt instrument if it provides for a contractual obligation to:

- deliver cash or another financial asset to another entity;
- exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the Group; or
- satisfy the obligation other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of own equity shares.

If the Group does not have an unconditional right to avoid delivering cash or another financial asset to settle its contractual obligation, the obligation meets the definition of a financial liability.

#### Offsetting Financial Instruments

Financial assets and financial liabilities are offset and the net amount is reported in the consolidated statements of financial position if, and only if, there is a currently enforceable legal right to offset the recognized amounts and there is an intention to settle on a net basis, or to realize the asset and settle the liability simultaneously. This is not generally the case with master netting agreements, and the related assets and liabilities are presented gross in the consolidated statements of financial position.

The table below presents a comparison by category of carrying amounts and fair values of the Group's financial instruments as of September 30, 2012 and December 31, 2011:

|                             | <u>September 30, 2012</u> |                   | <u>December 31, 2011</u> |                   |
|-----------------------------|---------------------------|-------------------|--------------------------|-------------------|
|                             | <u>Carrying Value</u>     | <u>Fair Value</u> | <u>Carrying Value</u>    | <u>Fair Value</u> |
| Financial assets (FA):      |                           |                   |                          |                   |
| Cash and cash equivalents   | <b>P21,627</b>            | <b>P21,627</b>    | P23,823                  | P23,823           |
| Trade and other receivables | <b>43,972</b>             | <b>43,972</b>     | 26,605                   | 26,605            |
| Due from related parties    | <b>11,426</b>             | <b>11,426</b>     | 23,787                   | 23,787            |
| Long-term receivables       | <b>390</b>                | <b>390</b>        | 88                       | 88                |
| Loans and receivables       | <b>77,415</b>             | <b>77,415</b>     | 74,303                   | 74,303            |

(Forward)

|   | September 30, 2012 |                 | December 31, 2011 |                 |
|---|--------------------|-----------------|-------------------|-----------------|
|   | Carrying Value     | Fair Value      | Carrying Value    | Fair Value      |
| AFS financial assets  | 927                | 927             | 1,036             | 1,036           |
| Financial assets at FVPL  | 119                | 119             | P194              | P194            |
| Derivative assets   | 39                 | 39              | 43                | 43              |
| FA at FVPL  | 158                | 158             | 237               | 237             |
| <b>Total financial assets</b>   | <b>P78,500</b>     | <b>P78,500</b>  | <b>P75,576</b>    | <b>P75,576</b>  |
| Financial liabilities (FL):   |                    |                 |                   |                 |
| Short-term loans  | P74,293            | P74,293         | P40,593           | P40,593         |
| Liabilities for crude oil and petroleum product importation                 | 44,435             | 44,435          | 13,842            | 13,842          |
| Trade and other payables (excluding specific taxes and other taxes payable) | 9,343              | 9,343           | 6,600             | 6,600           |
| Long-term debt including current portion                                    | 45,329             | 45,329          | 49,868            | 49,868          |
| Cash bonds  | 344                | 344             | 303               | 303             |
| Cylinder deposits   | 265                | 265             | 383               | 383             |
| Other noncurrent liabilities  | 47                 | 47              | 54                | 54              |
| FL at amortized cost  | 174,056            | 174,056         | 111,643           | 111,643         |
| Derivative liabilities  | 81                 | 81              | 55                | 55              |
| <b>Total financial liabilities</b>  | <b>P174,137</b>    | <b>P174,137</b> | <b>P111,698</b>   | <b>P111,698</b> |

The following methods and assumptions are used to estimate the fair value of each class of financial instruments and when it is practicable to estimate such value:

*Cash and Cash Equivalents, Trade and Other Receivables and Long-term Receivables.* The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of long-term receivables, the fair value is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

*Derivatives.* The fair values of freestanding and bifurcated forward currency transactions are calculated by reference to current forward exchange rates for contracts with similar maturity profiles. Marked-to-market valuation in 2012 and 2011 of commodity hedges were based on the forecasted crude and product prices by Mitsui & Co. Commodity Risk Management Ltd. (MCRM), an independent trading group.

*Financial Assets at FVPL and AFS Financial Assets.* The fair values of publicly traded instruments and similar investments are based on quoted market prices in an active market. For debt instruments with no quoted market prices, a reasonable estimate of their fair values is calculated based on the expected cash flows from the instruments discounted using the applicable discount rates of comparable instruments quoted in active markets. Unquoted equity securities are carried at cost less impairment.

*Long-term Debt - Floating Rate.* The carrying amounts of floating rate loans with quarterly interest rate repricing approximate their fair values.

*Cash Bonds.* Fair value is estimated as the present value of all future cash flows discounted using the market rates for similar types of instruments.

#### Derivative Financial Instruments

The Group's derivative financial instruments according to the type of financial risk being managed and the details of freestanding and embedded derivative financial instruments are discussed below.

The Group enters into various currency and commodity derivative contracts to manage its exposure on foreign currency and commodity price risk. The portfolio is a mixture of instruments including forwards, swaps and options. These include freestanding and embedded derivatives found in host contracts, which are not designated as accounting hedges. Changes in fair value of these instruments are recognized directly in profit or loss.

The Group's derivative financial instruments according to the type of financial risk being managed are discussed below.

#### Freestanding Derivatives

Freestanding derivatives consist of commodity and currency derivatives entered into by the Group.

#### *Currency Forwards*

As of September 30, 2012 and December 31, 2011, the Group has outstanding foreign currency forward contracts with aggregate notional amount of US\$604 and US\$220, respectively with various maturities up to November 2012. As of September 30, 2012 and December 31, 2011, the net positive (negative) fair value of these currency forwards amounted to (P73) and P40, respectively.

#### *Commodity Swaps*

The Group has outstanding swap agreements covering its oil requirements, with various maturities in 2012. Under the agreements, payment is made either by the Group or its counterparty for the difference between the hedged fixed price and the relevant monthly average index price.

The outstanding equivalent notional quantities covered by the commodity swaps as of September 30, 2012 and December 31, 2011 were 2.0 million barrels and 1.8 million barrels,

respectively. As of September 30, 2012 and December 31, 2011, the net positive (negative) fair values of these swaps amounted to (P68) and P147, respectively.

#### *Commodity Options*

The Group has outstanding commodity options covering its crude oil requirements with notional quantity of 0.8 million barrels and 1.3 million barrels as of September 30, 2012 and December 31, 2011, respectively. These call and put options can be exercised at various calculation dates in 2012 with specified quantities on each calculation date. The net positive (negative) fair value of these options as of September 30, 2012 and December 31, 2011 amounted to (P283) and P47, respectively.

#### *Embedded Derivatives*

The Group assesses whether embedded derivatives are required to be separated from the host contracts when the Group becomes a party to the contract.

An embedded derivative is separated from the host contract and accounted for as a derivative if all of the following conditions are met: a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract; b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and c) the hybrid or combined instrument is not recognized at FVPL. Reassessment only occurs if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required.

#### *Embedded Currency Forwards*

As of September 30, 2012 and December 31, 2011, the total outstanding notional amount of currency forwards embedded in non-financial contracts amounted to US\$80 and US\$91, respectively. These non-financial contracts consist mainly of foreign currency-denominated service contracts, purchase orders and sales agreements. The embedded forwards are not clearly and closely related to their respective host contracts. As of September 30, 2012 and December 31, 2011, the net positive (negative) fair value of these embedded currency forwards amounted to P31 and (P52), respectively.

For the periods ended September 30, 2012 and December 31, 2011, the Group recognized marked-to-market gains from freestanding and embedded derivatives amounting to P313 and P205, respectively.

#### Fair Value Hierarchy

Financial assets and liabilities measured at fair value in the consolidated statements of financial position are categorized in accordance with the fair value hierarchy. This hierarchy groups financial assets and liabilities into three levels based on the significance of inputs used in measuring the fair value of the financial assets and liabilities.

The table below analyzes financial instruments carried at fair value by valuation method as of September 30, 2012 and December 31, 2011. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.

- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: inputs for the asset or liability that are not based on observable market data.

| <b>September 30, 2012</b>    | <b>Level 1</b> | <b>Level 2</b> | <b>Total</b> |
|------------------------------|----------------|----------------|--------------|
| <b>Financial Assets</b>      |                |                |              |
| Financial assets at FVPL     | P119           | P-             | P119         |
| Derivative assets            | -              | 39             | 39           |
| AFS financial assets         | -              | 927            | 927          |
| <b>Financial Liabilities</b> |                |                |              |
| Derivative liabilities       | -              | (81)           | (81)         |

| <b>December 31, 2011</b>     | <b>Level 1</b> | <b>Level 2</b> | <b>Total</b> |
|------------------------------|----------------|----------------|--------------|
| <b>Financial Assets</b>      |                |                |              |
| Financial assets at FVPL     | P194           | P-             | P194         |
| Derivative assets            | -              | 43             | 43           |
| AFS financial assets         | -              | 1,036          | 1,036        |
| <b>Financial Liabilities</b> |                |                |              |
| Derivative liabilities       | -              | (55)           | (55)         |

As of September 30, 2012 and December 31, 2011, the Group has no financial instruments valued based on Level 3. During the year, there were no transfers between Level 1 and Level 2 fair value measurements and no transfers into and out of Level 3 fair value measurements.

## **11. Significant Transactions During the Period**

- On January 24, 2012, PCERP disposed 695,300,000 common shares at a price of P11.00 per share through the facilities of the Philippine Stock Exchange. PCERP engaged Credit Suisse, (Singapore) Limited, Standard Chartered Securities (Singapore) Pte. Limited., and UBS AG to act as placement agents for the transaction.
- On February 15, 2012 the Parent Company availed of the remaining US\$400 million of the US\$480 million term loan facility which was signed and executed on September 30, 2011.
- On March 14, 2012, Petron Global Limited, the offshore subsidiary of the Parent Company in the British Virgin Islands, issued 150,000,000 cumulative, non-voting, non-participating and non-convertible preferred shares series A and 200,000,000 cumulative, non-voting, non-participating and non-convertible preferred shares series B at an issue price equal to the par value of each share of US\$1.
- On March 30, 2012, the Parent Company's indirect offshore subsidiary, POGI, completed the acquisition of 65% of Esso Malaysia Berhad (EMB), and 100% of ExxonMobil Malaysia Sdn

Bhd (EMMSB) and ExxonMobil Borneo Sdn Bhd (EMBSB) for an aggregate purchase price of US\$577.3 million. POGI also served the notice of mandatory general offer (MGO) to acquire the remaining 94,500,000 shares representing 35% of the total voting shares of EMB for RM3.59 per share from the public. The Unconditional Mandatory Take-Over Offer was closed on May 14, 2012. As a result of the MGO, POGI was able to acquire an additional 22,679,063 shares from the public and increased its interest in EMB to 73.4%.

On April 23, 2012, the Companies Commission of Malaysia (CCM) approved the change of name of EMMSB to Petron Fuel International Sdn Bhd and of EMBSB to Petron Oil (M) Sdn Bhd. Thereafter, on July 11, 2012, the CCM approved the change of name of EMB to Petron Malaysia Refining & Marketing Bhd.

- e. On April 13, 2012, the Parent Company completed the acquisition from Two San Isidro - SIAI Assets, Inc. of the latter's shares in Limay Energen Corporation.
- f. In April 2012, NVRC acquired 100% of Parkville Estate and Development Corporation and also paid P60 representing deposit for future subscription in South Luzon Prime Holdings Inc.

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## 12. Other Matters

- a. On July 26, 2012, NVRC entered into an agreement for the acquisition of 60% of the outstanding capital stock of Mariveles Landco Corporation (MLC) for US\$0.6 million.
- b. There were no unusual items as to nature and amount affecting assets, liabilities, equity, net income or cash flows, except those stated in Management's Discussion and Analysis of Financial Position and Performance.
- c. There were no seasonal aspects that had a material effect on the financial position or financial performance of the Group.
- d. There were no material off-statements of financial position transactions, arrangements, obligations (including contingent obligations), and other relationship of the Group with unconsolidated entities or other persons created during the reporting period, except for the outstanding derivative transactions entered by the Group as of and for the period ended September 30, 2012.
- e. Certain amounts in prior year have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations for any period.
- f. Known trends, demands, commitments, events or uncertainties that will have a material impact on the Group's liquidity:

### Gross Domestic Product (GDP)

The Philippine economy sustained its momentum with 2012's second quarter GDP growing robustly by 5.9% from 3.6% in second quarter 2011. This brings 2012's first half growth at 6.1%. Strong growth was boosted by sustained consumer spending, recovery in exports, and surge of government consumption. After under spending in 2011, the government is accelerating expenditures and implementation of projects. Public-Private Partnership (PPP)

projects stalled last year are now being rolled out and implemented this year.

### 91-Day Treasury-Bill Rate

91-day treasury bills remained low with 2012's third quarter rates averaging at 1.5% from 1.8% in third quarter of 2011. Low interest rates were sustained in 2012 due to the sufficient liquidity in the domestic financial markets and low inflation.

### Peso-Dollar Exchange Rate

The Peso further strengthened in the third quarter of 2012 averaging at Php41.9/USD, bringing 9-month average at Php42.6/USD, stronger than Php43.3/USD in the same period last year. The continuously growing remittances of overseas Filipino workers (OFW), rebound of exports, and higher foreign investments supported peso's strength.

### Inflation

Inflation averaged 3.2% in the first nine months of 2012, lower than the 4.7% average in the same period last year. Increase in prices of goods such as key food items have been gradual compared to 2011. Oil prices have also been lower especially during the second quarter of the year. First half average inflation is well within the government's target inflation of 3-5% for the year 2012.

### Dubai price

Oil prices have been very volatile in 2012. After peaking in March to more than USD120/bbl, Dubai dropped to below USD100/bbl in the second quarter, and recovered to more than USD100/bbl in the third quarter. Tensions in oil producing regions and uncertainties in the global economy are causing the volatility in oil prices. As of September 30, 2012, Dubai averaged USD109.6/bbl, slightly higher than USD106.2/bbl average in the same period last year.

### Industry Oil Demand

Preliminary data from DOE shows that as of July 2012, total oil industry demand (excluding lubes and greases) increased by 2.2% to 64 million barrels (300 MBD) from 62 million barrels (293 MBD) in same period in 2011. Favorable business environment with strong economic



growth, subdued inflation, growing OFW remittances, and rising vehicle sales supported growth in oil demand.

### Tight Industry Competition

Competition remains stiff with the new players implementing different marketing strategies and aggressively expanding. As of July 2012, the new players (based on preliminary data from the DOE (excluding direct imports) have collectively cornered around 24.1% of the total oil market. Collectively, the new players are leading the LPG market segment with 59.4% market share (large increase from 2011's 44% because of Shell's sale of its LPG business to new player Isla Gas).

### Updates on 2012 Capital Program

The 2012 capital program endorsed last December 2011 is P78.7 billion. Of this amount, P72.9 billion has already been approved and includes partial funding for the refinery expansion project and the service station network expansion.

- g. Known trends, events or uncertainties that have had or that are reasonably expected to have a favorable or unfavorable impact on net sales or revenues or income from continuing operation:

### Illegal Trading Practices

Cases of smuggling and illegal trading (e.g. "bote-bote" retailing, illegal refilling) continue to be a concern. These illegal practices have resulted in unfair competition among players.

### Existing or Probable Government Regulation

*Executive Order 890 (EO 890): Removing Import Duties on All Crude and Refined Petroleum Products.* . After the ASEAN Trade in Goods Agreement (ATIGA) was implemented starting 2010, tariff rate structure in the oil industry was distorted with crude and product imports from ASEAN countries enjoying zero tariff while crude and product imports from outside the ASEAN are levied 3%. To level the playing field, Petron filed a petition with the Tariff Commission to apply the same tariff duty on crude and petroleum product imports, regardless of source. In June 2010, the government approved the Parent Company's petition and issued EO 890 which eliminated import duties on all crude and petroleum products regardless of source. The reduction of duties took effect on July 4, 2010.

*Biofuels Act of 2006.* The Biofuels Act of 2006 mandates that ethanol comprise 5% of total gasoline volumes, and diesel contain 2% cocomethyl ester (CME). By February 2012, all gasoline grades should contain 10% ethanol. However, the DOE extended an exemption to regular gasoline and gasoline with 97 and above RON from the mandated ethanol content pending completion of technical testing on ethanol compatibility with motor vehicle engines especially the 2-stroke motorcycle engines.

To produce compliant fuels, the Parent Company invested in CME injection systems at the refinery and depots. Prior to the mandatory blending of ethanol into gasoline by 2009, the Parent Company had already started selling ethanol blended gasoline in selected service stations in Metro Manila in May 2008.

*Renewable Energy Act of 2008.* The Renewable Energy Act signed in December 2008 aims to promote development and commercialization of renewable and environment-friendly energy resources (e.g. biomass, solar, wind) through various tax incentives. Renewable energy developers will be given 7-year income tax holiday, power generated from these sources will be VAT-exempt, and facilities to be used or imported will also have tax incentives.

*Laws on Oil Pollution.* To address issues on marine pollution and oil spillage, the Maritime Industry Authority mandated the use of double-hull vessels for transporting black products beginning end-2008 and by January 2012 for white products.

The Parent Company has already been using double-hull vessels in transporting all black products and some white products.

*Clean Air Act.* The Parent Company invested in a Gasoil Hydrotreater Plant and in an Isomerization Plant to enable it to produce diesel and gasoline compliant with the standards set by law.

*Liquefied Petroleum Gas (LPG) Bill.* This bill aims to ensure safe practices and quality standards and mitigate unfair competition in the LPG sector. LPG cylinder seal suppliers must obtain a license and certification of quality, health and safety from the DOE before they are allowed to operate. LPG cylinder requalifiers, repairers and scrapping centers will also have to obtain a license from the Department of Trade and Industry. The bill also imposes penalties on underfilling, underdelivering, illegal refilling and storage, sale or distribution of LPG-filled cylinders without seals, illegal possession of LPG cylinder seal, hoarding, and importation of used or second-hand LPG cylinders, refusal of inspection, and non-compliance to standards.

*Inclusion of LPG and kerosene in Price Act.* An amendment to the Price Act is proposed to include LPG and kerosene to the list of basic necessities which are under strict monitoring by the government. Prices of these goods can be subject to price control or price ceiling on the event of emergencies, calamities, war, rebellion, etc.

*Compliance with Euro 4 standards.* The Department of Environment and Natural Resources (DENR) issued on September 2010 an administrative order (AO 2010-23) mandating that by 2016 all new motor vehicles that will be introduced in the market shall comply with Euro 4 emission limits subject to Euro 4 fuel availability. The oil industry is currently conducting discussions on the fuel specification requirements to comply with the DENR administrative order come 2016.

- h. Events that will trigger direct or contingent financial obligation that is material to the company, including any default or acceleration of an obligation.

### Tax Credit Certificates-Related Matters

In 1998, the BIR issued a deficiency excise tax assessment against the Parent Company relating to the Parent Company's use of P659 worth of TCCs to pay certain excise tax obligations from 1993 to 1997. The TCCs were transferred to the Parent Company by suppliers as payment for fuel purchases. The Parent Company contested the BIR's assessment before the CTA. In July 1999, the CTA ruled that, as a fuel supplier of BOI registered companies, the Parent Company was a qualified transferee of the TCCs and that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. On March 21, 2012, the Court of Appeals promulgated a decision in favor of the Parent Company and against the BIR affirming the ruling of the CTA striking down the assessment issued by the BIR for deficiency excise taxes in 1998 based on a finding by the BIR that the TCCs used by the Parent Company as payment were fraudulent. On April 19, 2012, a motion for reconsideration was filed by the BIR which was denied by the CTA in its Resolution dated October 10, 2012.

In 2002, the BIR issued a P254 assessment against the Parent Company for deficiency excise taxes for the years 1995 to 1998 resulting from the cancellation by the DOF of tax debit memos, the related TCCs and their assignment to the Parent Company. The Parent Company contested the assessment before the CTA. On May 4, 2007, the CTA Second Division denied the Parent Company's petition, ordering the Parent Company to pay the BIR P601 representing the Parent Company's P254 unpaid deficiency excise taxes for the taxable years 1995 to 1998 and 25% late payment surcharge and 20% delinquency interest per annum computed from June 27, 2002. The Parent Company appealed the decision to the CTA *en banc*, which ruled in favor of the Parent Company, reversing the unfavorable decision of the CTA Second Division. The BIR contested the CTA *en banc* decision before the Supreme Court. On March 21, 2012, the Supreme Court promulgated a decision in favor of the Parent Company and against the BIR affirming the decision of the CTA *en banc* finding that the BIR had no legal basis to assess the excise taxes or any penalty surcharge or interest thereon as the Parent Company was an innocent transferee for value of the subject TCCs which had therefore properly filed its tax returns, and paid the appropriate taxes using such TCCs, for the years 1995 to 1998. A motion was subsequently filed by the Office of the Solicitor General seeking for the reconsideration of the above decision. On July 11, 2012, the Supreme Court Second Division issued a resolution upholding its decision and denying the Office of the Solicitor General's motion for reconsideration with finality.

### Pandacan Terminal Operations

In November 2001, the City of Manila enacted Ordinance 8027 reclassifying the areas occupied by the oil terminals of the Parent Company, Shell and Chevron from industrial to commercial. This reclassification made the operation of the oil terminals in Pandacan, Manila illegal. However, in June 2002, the Parent Company, together with Shell and Chevron, entered into an MOU with the City of Manila and the DOE, agreeing to scale down operations, recognizing that this was a sensible and practical solution to reduce the economic impact of Ordinance 8027. In December 2002, in reaction to the MOU, the SJS filed a petition with the Supreme Court against the Mayor of Manila asking that the latter be ordered to enforce Ordinance 8027. In April 2003, the Parent Company filed a petition with the

Regional Trial Court (RTC) to annul Ordinance 8027 and enjoin its implementation. On the basis of a *status quo* order issued by the RTC, Mayor of Manila ceased implementation of Ordinance 8027.

The City of Manila subsequently issued the Comprehensive Land Use Plan and Zoning Ordinance (Ordinance 8119), which applied to the entire City of Manila. Ordinance 8119 allowed the Parent Company (and other non-conforming establishments) a seven-year grace period to vacate. As a result of the passage of Ordinance 8119, which was thought to effectively repeal Ordinance 8027, in April 2007, the RTC dismissed the petition filed by the Parent Company questioning Ordinance 8027.

However, on March 7, 2007, in the case filed by SJS, the Supreme Court rendered a decision (March 7 Decision) directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, the Parent Company, together with Shell and Chevron, filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision. In the same year, the Parent Company also filed a petition before the RTC of Manila praying for the nullification of Ordinance 8119 on the grounds that the reclassification of the oil terminals was arbitrary, oppressive and confiscatory, and thus unconstitutional, and that the said ordinance contravened the provisions of the Water Code. On February 13, 2008, the Parent Company, Shell and Chevron were allowed by the Supreme Court to intervene in the case filed by SJS but their motions for reconsideration were denied. The Supreme Court declared Ordinance 8027 valid, and dissolved all existing injunctions against the implementation of the Ordinance 8027.

In May 2009, Manila City Mayor Alfredo Lim approved Ordinance 8187, which amended Ordinance 8027 and Ordinance 8119, and permitted the continued operations of the oil terminals in Pandacan.

On August 31, 2012, the RTC of Manila ruled that Section 23 of Ordinance 8119 relating to the reclassification of subject oil terminals had already been repealed by Ordinance 8187; hence any issue pertaining thereto had become moot and academic. The RTC Manila also declared Section 55 of Ordinance 8119 null and void for being in conflict with the Water Code. Nonetheless, the RTC upheld the validity of all other provisions of Ordinance 8119. On September 25, 2012, the Parent Company sought clarification and partial consideration of the August 31 decision, and prayed for the nullification of the entire Ordinance 8119.

With regard to Ordinance 8187, petitions were filed before the Supreme Court, seeking for its nullification and the enjoinder of its implementation. The Parent Company filed a manifestation on November 30, 2010 informing the Supreme Court that, without prejudice to its position in the cases, it had decided to cease operation of its petroleum product storage facilities in Pandacan within 5 years or not later than January 2016 due to the many unfounded environmental issues being raised that tarnish the image of the Parent Company and the various amendments being made to the zoning ordinances of the City of Manila when the composition of the local government changes prevented the Parent Company from making long-term plans. In a letter dated July 6, 2012 (with copies to the offices of the Vice Mayor and the City Council of Manila), the Parent Company reiterated its commitment to cease the

operation of its petroleum product storage facilities and transfer them to another location by January 2016.

#### Guimaras Oil Spill Incident

On August 11, 2006, MT Solar I, a third party vessel contracted by the Parent Company to transport approximately two million liters of industrial fuel oil, sunk 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the DOJ and the SBM, both agencies found the owners of MT Solar I liable. The DOJ found the Parent Company not criminally liable, but the SBMI found the Parent Company to have overloaded the vessel. The Parent Company has appealed the findings of the SBMI to the DOTC and is awaiting its resolution. The Parent Company believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as the Parent Company, which are charterers.

In 2009, complaints for violation of the Clean Water Act and homicide and less serious physical injuries were filed against the Parent Company. Complainants claim that their exposure to and close contact with waters along the shoreline and mangroves affected by the oil spill has caused them major health problems. On February 13, 2012, an Information was filed against the owner and the Captain of MT Solar 1 and Messrs. Khalid Al-Faddagh and Nicasio Alcantara, former President and Chairman of the Parent Company, respectively, for violation of the Clean Water Act. On March 28, 2012, the court dismissed the information for lack of probable cause and for lack of jurisdiction over the offense charged. The Provincial Prosecutor and the private prosecutor filed a motion for reconsideration of this March 28 Order of the court. On August 13, 2012, the court issued an order denying the said motion for reconsideration.

Other complaints for non-payment of compensation for the clean-up operations during the oil spill were filed by a total of 1,063 plaintiffs who allegedly did not receive any payment of their claims for damages arising from the oil spill. The total claims for both cases amount to P292. The cases are presently under mediation for possible amicable settlement among the parties.



Petron Corporation and Subsidiaries  
Receivables  
September 30, 2012  
(Amounts in Millions of Pesos)

Breakdown:

|                                  |          |               |
|----------------------------------|----------|---------------|
| Accounts Receivable - Trade      | P        | 20,947        |
| Accounts Receivable - Non-Trade  |          | 23,025        |
| <b>Total Accounts Receivable</b> | <b>P</b> | <b>43,972</b> |

AGING OF TRADE ACCOUNTS RECEIVABLES

|                                    |              |          |               |
|------------------------------------|--------------|----------|---------------|
| Receivables                        | 1-30 days    | P        | 20,437        |
|                                    | 31-60 days   |          | 151           |
|                                    | 61-90 days   |          | 229           |
|                                    | Over 90 days |          | <u>1,247</u>  |
| <b>Total</b>                       |              |          | <b>22,064</b> |
| Allowance for doubtful accounts    |              |          | <u>1,117</u>  |
| <b>Accounts Receivable - Trade</b> |              | <b>P</b> | <b>20,947</b> |

## Interim Financial Report as of September 30, 2012

### Management's Discussion and Analysis of Financial Position and Performance

On March 30, 2012, the Parent Company's indirect offshore subsidiary, POGI, completed the acquisition of 65% of Esso Malaysia Berhad (EMB), and 100% of ExxonMobil Malaysia Sdn Bhd (EMMSB) and ExxonMobil Borneo Sdn Bhd (EMBSB) (POGI, EMB, EMMSB, and EMBSB are collectively hereinafter referred to as "Petron Malaysia"). Following the completion of the Unconditional Mandatory Take-Over Offer required by Malaysian laws to be undertaken by POGI, POGI's interest in EMB increased to 73.4%. EMB, EMMSB and EMBSB were later renamed Petron Malaysia Refining & Marketing Bhd, Petron Fuel International Sdn Bhd and Petron Oil (M) Sdn Bhd, respectively.

### Financial Performance

#### 2012 vs 2011

Petron posted a net income of **₹ 932 million** for the first three quarters of 2012. This is substantially lower than the **₹ 7.60 billion** earnings realized during the same period last year due mainly to the contraction in gross margin as a result of the continuing volatility in the global oil market. Nevertheless, the company was able to generate earnings of P500 million in the third quarter from a loss of P2.1 billion in the second quarter of 2012. It will be recalled that Petron reported a net income of P2.5 billion in the first three months of 2012.

| (In Million Pesos)                  | 2012       |   | 2011         |   | Variance-Fav (Unfav) |             |
|-------------------------------------|------------|---|--------------|---|----------------------|-------------|
|                                     | Amt        | % | Amt          | % | Amt                  | %           |
| Sales                               | 307,341    |   | 201,929      |   | 105,412              | 52          |
| Cost of Goods Sold                  | 293,895    |   | 183,638      |   | (110,257)            | (60)        |
| Gross Margin                        | 13,446     |   | 18,291       |   | (4,845)              | (26)        |
| Selling and Administrative Expenses | 6,906      |   | 4,856        |   | (2,050)              | (42)        |
| Non-operating Charges               | 5,430      |   | 3,322        |   | (2,108)              | (63)        |
| <b>Net Income</b>                   | <b>932</b> |   | <b>7,600</b> |   | <b>(6,668)</b>       | <b>(88)</b> |
| EBITDA                              | 9,719      |   | 15,727       |   | (6,008)              | (38)        |
| Sales Volume (MB)                   | 53,156     |   | 34,284       |   | 18,872               | 55          |
| Earnings per Share                  | (0.01)     |   | 0.73         |   | (0.74)               | (High)      |
| Return on Sales (%)                 | 0.3        |   | 3.8          |   | (3.5)                | (92)        |

With the decline in bottom line, **earnings before interest, taxes, depreciation and amortization (EBITDA)** also deteriorated from the **₹ 15.73 billion** level a year earlier to **₹ 9.72 billion** this year.

**Loss per share of ₹ 0.01** was a turnaround from the **₹ 0.73** earnings per share of the previous year while **return on sales** decreased from **3.8%** to **0.3%**.

**Gross margin (GM)** dropped to **₱ 13.45 billion** from the previous year's ₱ 18.29 billion. The following account for the variance in gross margin:

- ◆ **Sales volume** for the nine-month period increased to **53.2MMB** from last year's 34.3MMB primarily due to the consolidation of Petron Malaysia (17.6 MMB) in the second quarter of 2012. Meanwhile, Philippine operations grew by 4% owing to the 9% (2.8 MMB) increase in the domestic market which more than made up for the 38% (1.5 MMB) decline in exports.
- ◆ **Net sales revenue** rose by 52% to **₱ 307.34 billion** from ₱ 201.93 billion in the previous year due to Petron 4% improvement in sales volume and 3% hike in average selling price per barrel (2012: US\$140.35 vs 2011: US\$136.15). Petron Malaysia contributed 31% of the total revenues.
- ◆ **Cost of Goods Sold (CGS)** escalated to **₱ 293.90 billion** from last year's ₱ 183.64 billion driven by the 8% increase in the average cost per barrel (2012: US\$133.27 vs 2011: US\$123.82) and the growth in sales volume. Of the total cost, thirty-one (31) percent pertained to Petron Malaysia.
- ◆ **Refinery Operating Expenses** in the Philippines which formed part of the total CGS went up to **₱ 4.80 billion** from ₱ 4.12 billion last year. The increase was attributed primarily to higher maintenance and repair works related to the shutdown of various process units and turnaround of tanks.
- ◆ **Selling and Administrative Expenses** of **₱ 6.91 billion** exceeded last year's ₱ 4.86 billion expenditures by 42%. Philippine operation's operating expenses increased by 9% due to more aggressive advertising campaigns, maintenance and repairs, depreciation of newly built service stations and depot facilities, expenses related to the acquisition of Petron Malaysia and donation to typhoon Sendong victims in Cagayan de Oro. Petron Malaysia added ₱1.62 billion to the total expense.
- ◆ **Net Financing Costs and Other Charges** stood higher by 63% to **₱ 5.43 billion** from the year ago charges of ₱ 3.32 billion. The increase in average borrowing level despite lower borrowing rate resulted in higher interest expense and bank charges. Losses from commodity hedging transactions also contributed to the increment. Petron Malaysia added 18% to the total charges.

### 2011 vs 2010

For the first nine months of 2011, revenues surged to **₱ 201.93 billion** while net earnings amounted to **₱ 7.60 billion**. Higher income can be attributed to the growth in petrochemical sales which contributed about **₱ 2.50 billion** earnings.

With the improved bottom line, **earnings before interest, taxes, depreciation and amortization (EBITDA)** of **₱ 15.73 billion** also topped the ₱ 11.23 billion level a year earlier.



**Earnings per share** increased by 40% to **₱ 0.73** from ₱ 0.52 of the previous year while **return on sales** grew from 3.1% to **3.8%**.

| (In Million Pesos)                  | 2011         | 2010         | Variance- Fav (Unfav) |           |
|-------------------------------------|--------------|--------------|-----------------------|-----------|
|                                     |              |              | Amt                   | %         |
| Sales                               | 201,929      | 169,798      | 32,131                | 19        |
| Cost of Goods Sold                  | 183,638      | 156,479      | (27,159)              | (17)      |
| Gross Margin                        | 18,291       | 13,319       | 4,972                 | 37        |
| Selling and Administrative Expenses | 4,856        | 4,149        | (707)                 | (17)      |
| Non-operating Charges               | 3,322        | 2,099        | (1,223)               | (58)      |
| <b>Net Income</b>                   | <b>7,600</b> | <b>5,347</b> | <b>2,253</b>          | <b>42</b> |
| EBITDA                              | 15,727       | 11,234       | 4,493                 | 40        |
| Sales Volume (MB)                   | 34,284       | 35,838       | (1,554)               | (4)       |
| Earnings per Share                  | 0.73         | 0.52         | 0.21                  | 40        |
| Return on Sales (%)                 | 3.8          | 3.1          | 0.7                   | 23        |

Major contributory factors are the following:

**Gross margin (GM)** rose to **₱ 18.29 billion** from previous year's ₱ 13.32 billion. The following account for the variance in gross margin:

- ◆ **Sales volume as of September 2011** ended lower at **34.3MMB** compared to last year's 35.8MMB as current level of prices resulted in a 7% (2.16MMB) contraction in the domestic market. Meanwhile, exports improved by 17% (0.62MMB). The slowdown in local sales came from Diesel (1,233MB) and Fuel Oil (1,774MB) mitigated by the growth in LPG and Jet (880MB).
- ◆ **Net sales revenue** grew by 19% to **₱ 201.93 billion** from ₱ 169.80 billion the year before essentially due to the hike in average selling price per liter (2011: ₱ 36.13 vs. 2010: ₱ 29.08) prompted by the 36% spike in regional MOPS prices (2011 Ave - US\$122.64/bbl vs. 2010 Ave - US\$90.48/bbl), tempered by the ₱ 2.33 average appreciation of the peso versus the US dollar.
- ◆ **Cost of Goods Sold (CGS)** went up to **₱ 183.64 billion** from last year's ₱ 156.48 billion as the average cost per liter increased by 22% (2011: ₱ 32.88 vs 2010: ₱ 26.94). Higher cost per liter was principally due to the 31% escalation in landed cost of crude that formed part of the total cost of goods sold (2011: US\$ 104.08/bbl vs 2010: US\$ 79.37).
- ◆ **Refinery Operating Expenses** which formed part of CGS rose to **₱ 4.12 billion** from ₱ 3.71 billion during the same period in 2010. This was attributed to increased power consumption due to higher cost per kilowatt-hour and higher maintenance and repairs on several facilities. Employee costs also moved up due largely to additional manpower complement and payment of signing bonus to rank-and-file employees.

- ◆ **Selling and Administrative Expenses** of **₱ 4.86 billion** exceeded last year's ₱ 4.15 billion expenditures as newly built service stations resulted in increased rent and depreciation. Materials and supplies also went up due to acquisition of LPG cylinders while aggressive promotional activities accounted for higher advertising expenses. With the surge in operating expenses despite the drop in volume, **opex per liter** of volume sold grew from ₱ 0.73 in 2010 to **₱ 0.89** in 2011.
- ◆ **Net Financing Costs and Other Charges** rose to **₱ 3.32 billion** from the ₱ 2.10 billion level as of September 2010. The increase in average borrowing level and rate (2011: ₱ 77.00 billion at 5.8% vs. 2010: ₱ 59.00 billion at 5.3%) resulted in higher interest expense. Losses from US-dollar denominated transactions also contributed to the increment. The increase was partly offset by the interest earned from advances to Petron Corporation Employees' Retirement Plan (PCERP), marked-to-market gains on Embedded Derivatives, and commodity hedging gains.

## Financial Position

### 2012 vs 2011

With the consolidation of Petron Malaysia, Petron's **total assets** as of September 30, 2012 reached **₱ 255.45 billion**, registering a **45%** or **₱ 79.65 billion** growth over the end-December 2011 level of ₱ 175.80 billion.

**Cash and cash equivalents** decreased by 9% (₱ 2.20 billion) from ₱ 23.82 billion to **₱ 21.63 billion**. Funds sourced from loan availments, issuance of preferred shares by Petron Global, partial collection of PCERP advances and cash generated from operations were used to finance investments on major capital projects at the Refinery, acquisition of Petron Malaysia and working capital requirements.

**Financial assets at fair value through profit or loss** went down by 33% from ₱ 237 million to **₱ 158 million** with the sale of a number of stock investments tempered by higher market value of club membership shares.

**Trade and other receivables-net** grew by 65% from ₱ 26.61 billion to **₱ 43.97 billion** owing to the balances of the newly acquired subsidiary in Malaysia and increase in collectibles from the Philippine government.

**Inventories** of **₱ 60.97 billion** rose by 61% or ₱ 23.21 billion from ₱ 37.76 billion attributed to inventories of Petron Malaysia coupled with Petron's higher volume and price of crude and finished products.

**Other current assets** increased by 44% from ₱ 8.18 billion to **₱ 11.81 billion** traced mainly to higher input VAT as well as prepaid taxes and other expenses of the newly acquired subsidiary.

**Property, plant and equipment-net** surged by 68% or ₱ 34.17 billion from ₱ 50.45 billion to **₱ 84.61 billion** essentially due to Petron's major capital expenditures at the Refinery such as the

Refinery Master Plan 2 (RMP2) and Refinery Solid Fuel-Fired Power Plant (RSFFPP), on top of Petron Malaysia's fixed assets.

Due to the purchase by Petron of the remaining 60% interest in Limay Energen Corp. (LEC) from Two San Isidro SIAI Assets, Inc., **Investment in associates** declined by more than half from ₱ 2.51 billion to **₱ 1.16 billion**.

**Investment property-net** went down by 9% from ₱ 794 million to **₱ 726 million** mainly due to depreciation of Petron MegaPlaza's office units.

**Available-for-sale financial assets** dropped by 11% or ₱ 109 million to **₱ 927 million** principally due to the decline in fair value of investment in bonds of Petron subsidiary in Bermuda, Overseas Ventures Insurance Corporation, together with the maturity and disposal of some bonds of Petron Philippine subsidiary, Petrogen Insurance Corporation..

**Deferred tax assets** increased significantly to **₱ 49 million** from ₱ 15 million in 2011 attributed to temporary differences of Petron Malaysia.

The acquisition of Petron Malaysia and Parkville Estate and Development Corporation gave rise to the recognition of **₱ 10.43 billion Goodwill**.

**Other noncurrent assets-net** dipped by 22% from ₱ 24.38 billion to **₱ 19.00 billion** prompted by the partial collection of advances to PCERP partly offset by the balance of the newly acquired subsidiary in Malaysia.

**Short-term loans and liabilities for crude oil and petroleum product importation** of **₱ 118.73 billion** more than doubled the ₱ 54.44 billion December 2011 level due largely to the consolidation of Petron Malaysia, coupled with higher volume and price of crude and finished product importations of PSTPL and Petron.

**Trade and other payables** escalated by 37% from ₱ 7.38 billion to **₱ 10.14 billion** brought about by Petron Malaysia's balance coupled with Petron's higher retention payable to contractors for its major capital projects at the Refinery.

**Derivative liabilities of ₱ 81 million** moved up by 47% from ₱ 55 million in December 2011 owing to the marked-to-market loss on freestanding derivatives partly reduced by higher fair value of outstanding embedded derivatives.

**Income tax payable** was reduced by 8% from ₱ 78 million to **₱ 72 million** due to lower taxes payable of PSTPL.

**Long-term debt inclusive of current portion** ended lower by 9% from ₱ 49.87 billion to **₱ 45.33 billion** with the full settlement of the Development Bank of the Philippines, Norddeutsche Landesbank Girozentrale and the US\$80 million loans.

**Retirement benefits liability** of **₱ 1.47 billion** stood more than twice the end-December 2011 balance of ₱ 671 million mainly because of the balance from the newly acquired subsidiary in Malaysia.

**Deferred tax liabilities** went up by 48% from ₱ 1.82 billion to **₱ 2.69 billion** essentially due to the temporary differences of Petron Malaysia.

**Other noncurrent liabilities** improved by 11% or ₱ 84 million from ₱ 740 million to **₱ 656 million** on account largely of lower cylinder deposits.

**Total equity** at the end of September 2012 surged to **₱ 75.20 billion** and showed a 26% or ₱ 15.51 billion increase from the ₱ 59.69 billion level as at end-December 2011, attributed mainly to the consolidation of Petron subsidiary in the British Virgin Islands, Petron Global Limited.

### 2011 vs 2010

As of September 30, 2011, **consolidated resources** stood at **₱ 170.96 billion**, 6% (₱ 9.14 billion) higher compared to end-December 2010 level of ₱ 161.82 billion due to the combined effects of the following:

**Cash and cash equivalents** dropped by 54% to **₱ 20.40 billion** primarily to fund working capital requirement (Inventories and Receivables), capital expenditures and other investments.

**Financial assets at fair value through profit or loss** were up by 42% from ₱ 227 million to **₱ 323 million** brought about by the strengthened fair value of freestanding derivatives partly offset by the decline in market value of investments in marketable securities and club membership shares.

**Trade and other receivables-net** rose by 7% (₱ 1.74 billion) to **₱ 26.00 billion** from the ₱ 24.27 billion level in December 2010 attributed to increased sales to industrial customers.

**Inventories** grew significantly from ₱ 28.15 billion to **₱ 47.09 billion** largely due to higher crude price and volume.

**Other current assets** of **₱ 7.09 billion** surpassed the ₱ 4.29 billion level as at year-end of 2010 owing to higher Input VAT as a result of higher purchase price of crude and finished products.

The drop in **Assets held for sale** from ₱ 832 million to **₱ 10 million** pertained to the transfer of Petron Mega Plaza to **Investment property-net** which surged to **₱ 817 million** from ₱ 119 million.

**Property, plant and equipment-net** increased by 23% from ₱ 34.96 billion to **₱ 42.98 billion** due to various capital projects in the refinery such as the RSFFPP and RMP2 as well as additional service stations.

**Investment in associates** increased from ₱ 804 million to **₱ 1.32 billion** with the purchase of 35% interest in Manila North Harbour Port, Inc.

**Available-for-sale financial assets** (current and non-current) fell to **₱ 1.03 billion** from ₱ 1.16 billion in December 2010 resulting from lesser investments in government securities and corporate bonds during the period.

**Deferred tax assets** went up to **₱ 170 million** from ₱ 28 million in 2010 due essentially to the effect of unrealized profit from subsidiaries.

**Short-term loans and liabilities for crude oil and petroleum product importation of ₱ 57.37 billion** surged by 31% (₱ 13.72 billion), an offshoot of higher crude and finished product prices this year.

**Derivative liabilities** of **₱ 97 million** more than tripled the ₱ 30 million level as at end of December 2010 due to higher notional amounts heightened by deteriorating fair value of embedded derivative transactions.

**Income tax payable** ballooned from ₱ 14 million to **₱ 532 million** prompted by higher taxable income during the nine-month period. The December 2010 taxable income considered the net operating loss carry-over (NOLCO) of prior years. In addition, last year's tax due was reduced by the utilization of past years' minimum corporate income tax (MCIT) as against zero this year.

**Long-term debt inclusive of current portion** went lower by 20% from ₱ 54.40 billion to **₱ 43.28 billion** with the settlement of maturing loans.

**Deferred tax liabilities** of **₱ 1.77 billion**, showed a 9% reduction from the ₱ 1.96 billion balance as at December 31, 2010 after considering the impact of temporary differences in income tax computation.

**Asset retirement obligation** escalated by 8% (₱ 63 million) to **₱ 878 million** on account of higher accretion rate.

**Other noncurrent liabilities** perked up by 15% (₱ 93 million) to **₱ 702 million** with the increase in cylinder deposit and cash bonds.

**Total equity** amounted to **₱ 59.29 billion**, 11% higher than the ₱ 53.34 billion level in December 2010, traceable to the **₱ 7.58 billion** income realized during the first nine months of the year partly offset by cash dividends paid to preferred and common shareholders totaling **₱ 1.65 billion**.

### Cash Flow

Operating activities contributed **₱ 3.42 billion** to the company's cash balance. Meanwhile, proceeds from partial collection of advances to PCERP were used to finance the expansion at the Refinery, construction of additional service stations and the acquisition of Petron Malaysia. Cash provided by financing activities emanated from net availment of loans and issuance of preferred shares.

| In Million Pesos              | September 30,<br>2012 | September 30,<br>2011 | Change   |
|-------------------------------|-----------------------|-----------------------|----------|
| Operating inflows (outflows)  | 3,415                 | (641)                 | 4,056    |
| Investing outflows            | (32,974)              | (13,057)              | (19,917) |
| Financing inflows (outflows ) | 27,451                | (9,947)               | 37,398   |

**Discussion of the company's key performance indicators:**

| Ratio                        | September 30,<br>2012 | December 31,<br>2011 |
|------------------------------|-----------------------|----------------------|
| Current Ratio                | 1.1                   | 1.5                  |
| Debt to Equity Ratio         | 2.4                   | 1.9                  |
| Assets to Equity Ratio       | 3.4                   | 2.9                  |
| Interest Rate Coverage Ratio | 1.7                   | 3.6                  |
| Return on Equity (%)         | 2%                    | 15%                  |

Current Ratio: Total current assets divided by total current liabilities. This ratio is a rough indication of a company's ability to service its current obligations. Generally, the higher the current ratio, the greater the "cushion" between current obligations and a company's ability to pay them.

Debt to Equity Ratio: Total liabilities divided by tangible net worth. This ratio expresses the relationship between capital contributed by creditors and that contributed by owners. It expresses the degree of protection provided by the owners for the creditors. The higher the ratio, the greater the risk being assumed by creditors. A lower ratio generally indicates greater long-term financial safety.

Assets to Equity Ratio: Total assets divided by total equity (including non-controlling interest). This ratio is used as a measure of financial leverage and long-term solvency. In essence, the function of the ratio is to determine the value of the total assets of the company, less any portion of the assets that are owned by the shareholders of the corporation.

Interest Rate Coverage Ratio: EBITDA divided by interest expense and other financing charges. This ratio is used to assess the company's financial stability by examining whether it is at least profitable enough to pay off its interest expenses. A ratio greater than 1 indicates that the company has more than enough interest coverage to pay off its interest expense.

Return on Equity: Net income divided by average total stockholders' equity. This ratio reveals how much profit a company earned in comparison to the total amount of shareholder equity found on the statements of financial position. A business that has a high return on equity is more likely to be one that is capable of generating cash internally. For the most part, the higher a company's return on equity compared to its industry, the better.

## **PART II – OTHER INFORMATION**

The issuer may, at its option, report under this item any information not previously reported in a report on SEC Form 17-C. If disclosure of such information is made under this Part II, it need not be repeated in a report on Form 17-C which would otherwise be required to be filed with respect to such information or in a subsequent report on Form 17-Q.

NONE.

## SIGNATURES

Pursuant to the requirements of the Securities Regulation Code, the issuer has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Registrant: PETRON CORPORATION

Signature and Title:  \_\_\_\_\_  
JOEL ANGELO C. CRUZ  
Corporate Secretary

Date: November 14, 2012

Principal Financial/Accounting Officer/Controller

Signature and Title:  \_\_\_\_\_  
EFREN P. GABRILLO  
Vice President and Controller

Date: November 14, 2012