REPUBLIC OF THE PHILIPPINES
OFFICE OF THE PRESIDENT

SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-A

ANNUAL REPORT PURSUANT TO SECTION 17 OF THE SECURITIES REGULATION CODE AND SECTION 141 OF THE CORPORATION CODE OF THE PHILIPPINES

1. For the fiscal year ended December 31, 2006

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. 358 Senator Gil Puyat Avenue, Makati City
Address of principal office
1200
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

....
....

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

Yes [X] No [ ]

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

Philippine Stock Exchange Common Stocks

12. Check whether the registrant:

(a) has filed all reports required to be filed by Section 17 of the SRC and SRC Rule 17 thereunder or Section 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 that the registrant was required to file such reports);

Yes [X] No [ ]

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

Yes [ ] No [X]

13. The aggregate market value of the voting stock held by non-affiliates of the Registrant is P38.4 billion based on the PSE price of P4.10 as of December 29, 2006.

DOCUMENTS INCORPORATED BY REFERENCE

N o n e

PART I - BUSINESS

(A) Description of Business

(1) Business Development

Petron

Incorporated in the Philippines in 1966 as Esso Philippines, Inc., Petron Corporation is the largest refiner and marketer of petroleum products in the Philippines. The company was renamed Petrophil Corporation in 1973 when the Philippine National Oil Company (PNOC) acquired Esso. In 1985, Petrophil Corporation and Bataan Refinery Corporation (formerly the Standard Vacuum Refining Corporation) were merged with Petrophil as the surviving Corporation. Petrophil later changed its corporate name to Petron Corporation.

On March 4, 1994, PNOC sold 40% of its shares in Petron to Aramco Overseas Company B.V., a wholly owned subsidiary of Saudi Arabian Oil Company (SAUDI ARAMCO). On September 7, 1994, 20% of Petron's shares were listed with the Philippine Stock Exchange in the biggest Initial Public Offering (IPO) in the Philippines.

Subsidiaries

At present, Petron has six subsidiaries, namely:

- New Ventures Realty Corporation (NVRC) is a realty firm established on August 24, 1995. The company was then equally owned by Petron and the Retirement Fund. However, in June 2003, Petron increased its share to 79.95%. It is authorized to acquire and develop land but it does not engage in the subdivision business. Land suitable for use as service station sites, bulk plants or sales offices are purchased by NVRC. These properties are leased to Petron for use in the latter's operation. A wholly owned subsidiary of NVRC, Las Lucas Development Corporation was acquired in July 2003.

- Petrogen Insurance Corporation or Petrogen is a wholly owned subsidiary of Petron Corporation incorporated on August 23, 1996. It serves the insurance requirements of Petron and its allied business partners such as contractors, suppliers and dealers. Licensed by the Insurance Commission in November 1996, Petrogen has the authority to issue policies on fire, marine, casualty and bonds. Insurance provided excludes life insurance. In 2001, it was granted authority to cover insurance for accidental death and dismemberment, travel and directors' and officers' liability.

- Overseas Insurance Corporation or Ovincor was incorporated on November 16, 1995 under the laws of Bermuda for the purpose of expediting the reinsurance of Petron's insurable interests as covered by Petrogen Insurance Corporation. Reinsurance includes the insurance cover for the Refinery, the bulk plants and service station properties, petroleum and cargo insurance and performance bonds for Petron contractors and haulers as well.

- Petron Foundation, Inc. (PFI) was incorporated on July 25, 1996. PFI was created to function and operate as a charitable and research foundation; to handle social, environmental, and music and arts development projects of Petron; to institutionalize and intensify Petron's active involvement in corporate and social responsibility projects; to support scholarship programs for financially-handicapped but deserving students; and to participate in other social projects supported by Petron.

- Petron Freeport Corporation (formerly Petron Treats Subic, Inc) was incorporated on November 6, 2003. It is a Petron subsidiary empowered to, among others, sell on wholesale or retail fuels such as gasoline, kerosene, diesel, LPG, lubricants and greases as well as operate retail outlets, restaurants, convenience stores and the like. The company has its principal office at the Subic Bay Metropolitan Area (SBMA), and operates Petron's "mega station" at the SBMA.

- Petron Marketing Corporation (PMC) was incorporated on January 27, 2004 with the same business purpose as the Petron Freeport Corporation. The Retail Trade Liberalization Act paved the way for Petron to form a direct-retailing subsidiary. The new subsidiary operates company-owned, company-operated (COCO) service stations. It offers a complete range of fuel products. The COCO stations play a major part in launching market initiatives to strengthen the Petron brand and gives Petron the opportunity to quickly introduce innovations beyond the present services that are available in Petron stations.

The subsidiaries have no plans of engaging in other line of products or services than that provided to Petron.

Petron Corporation and any of its subsidiaries have not been the subject of any bankruptcy, receivership or similar proceedings.

Operating Highlights

Marketing

In 2006, Petron Corporation maintained its market leadership with a market share of 38.8% vs. 38.1% in the previous year.

Among the various trades, Petron has the biggest market shares in Industrial and Reseller with 43.2% and 34.8%%, respectively. Its performance in the Industrial Trade was marked by an increase in aviation sales by 12.8% from 2005. It has also been able to maintain its existing share in the fuel requirements of government offices like NPC, AFP and PNP. In the Reseller business, it was able to sustain its market leadership due to its strategic network development. During the year, 28 new service stations were completed bringing the total number to 1,246 which is the highest and about 30% of the total industry. The Reseller group also launched the Retail Excellence Achievement Program (REAP & Rule) and Volume Incentive Program (VIP) promo for service stations. For the LPG (Gasul) trade, the company ranked second with a market share of 29.1% compared to the new players' collective share of 40.7%. Its market share for this year is 1.5% points higher than last year. It made pioneering moves in promoting auto LPG and acquisition of new industrial customers. Five new Xtend Autogas refilling stations were opened and 50 branch stores were set up thru our dealers. In Lubes, Petron formally launched the Petron-branded lubricants in Cambodia and had its initial exports to Indonesia. It also acquired the toll blending of 4T oil for a motorcycle company. In the domestic market, Petron Lubes share was 32.8% while Shell got 37.1% as the latter became aggressive in its marketing program.

Petron also expanded the membership of its fleet card, BPI Mastercard and SM Advantage Card users. It also launched the Brand Health Tracking For Fuels and Lubes and the New Generation Petron Diesel Max Campaign. It also conducted the Xtra Mile Challenge economy.

Refinery

In 2006, The Engineering, Procurement and Construction of the PetroFluidized Cracker (PetroFCC) Project which consists of the conversion of the Thermofor Catalytic Cracking Unit (TCCU) and installation of a Propylene Recovery Unit was 44.6 % complete. This will allow the recovery of more white products like LPG, gasoline, aviation fuel, etc. in addition to propylene. The project has been issued the Environmental Compliance Certificate by the DENR and is expected to be completed in 2008.

The company will also install a Benzene-Toulene-Xylene (BTX) Recovery Unit to meet the increasing demand for petrochemicals. The BTX project consists of the revamping of the Mixed Xylene plant and Continuous Catalytic Reformer Unit from 17 to 22 MBSD and the installation of the new Benzene/Toulene Extraction and Recovery unit. The Basic Engineering Design (BED)for this project has been awarded and target completion is also in 2008.

To comply with the various environmental laws, Petron undertook various initiatives.

- **Clean Air Act (CAA)**

  The Refinery uses low-sulfur fuel oil for its refinery fuel to ensure compliance with the air emission standard of CAA. Its Sulfur Recovery unit was continuously operated to recover sulfur from the fuel gas which has reduced sulfur dioxide and nitrogen oxide emissions within environmental standards.

- **Clean Water Act**

  A Spent Caustic Biological Treatment Facility (SCBTF) was installed to facilitate the efficient pre-treatment of Phenolic Spent Caustic prior to processing in the Refinery's Waste Water Treatment Facility (WWTF). Aside from the SCBTF, the addition of two triton aerators at the Aeration pond of the WWTF and the use of a new bacterial culture also hastened the reduction of Biological Oxygen Demand in waste water thus ensuring compliance to refinery effluent standards.

- **Solid Waste Management Act**

  A Solid Waste Management Staging Facility was established to serve as the staging area for the Refinery's solid wastes which are segregated and collected in accordance with its solid waste management practices. The disposal, recycling and treatment of its solid wastes is outsourced to DENR accredited service providers.

- **Environmental Management System (EMS)**

  The Refinery's Environmental Management System was upgraded to the new ISO14001:2004 by the TUV Management Services, extending its certification up to May 2007. The certification covers Crude Oil Receipt, the Manufacturing Process and Distribution of the Products via Pier.

The Refinery also continued to fulfill its commitment to the local community and to social environmental programs . Some of the programs undertaken were:

- Through its "Pagamutan sa Barangay" program, it provided medical and dental services to residents of Alangan in Bataan. This was conducted in coordination with the Bataan Medical Society, Limay Community Center and Alangan Health Center.

- Its employees participated in the Kontra Kalat sa Dagat along the shoreline of Kitang, Limay, Bataan. They joined DENR's "Green Philippine Highways" by planting trees along the highway of Orani and also assisted in the oil spill recovery and clean up operations in Guimaras.

- The Refinery's Apprenticeship Program which was approved by TESDA in July 2005 was expanded. About 61 apprentices have joined the program and 20 of them were hired as part of its pool of employees.

Supply and Operations

Petron built its third LPG tank in Mandaue Terminal. This will increase its existing storage capacity from 1,000MT to 2,700MT and will allow the terminal to receive single-port discharging of large LPG vessels coming from abroad. This will result into a P78 million savings in transshipment costs and will enable us to support the increasing demand for LPG in Cebu.

Five terminals/depots were certified to ISO-14001. These are the Mandaue Terminal which attained its certification through Bureau Veritas Certification, while Zamboanga, Davao, Jimenez and Tagoloan depots hurdled the certification audits conducted by Moody International Certification group. The new Environmental Management System being put in place in terminals and depots will help ensure that no harmful substances and wastes will be introduced into the environment during the handling and loading of fuel products for delivery to customers.

The annual quality audit for aviation fuel handling in Petron was made last November 2006. The Air Total inspector visited major aviation facilities and operations, namely, Bataan Refinery, Pandacan Terminal, Joint Oil Company Av-Fuel Storage Plant(JOCASP), NAIA Into-Plane Operations, Davao and Mactan Depots, Airport Depots at Davao and Laoag and the Into-Plane Operations of these sites and Mactan Into-Plane Operations. Based on the stringent standards of the internationally recognized and highly respected Joint Inspection Group (JIG), these sites and their operations were given an above average rating. In addition to the inspection, the JIG inspector conducted an Aviation Fuel Handling Seminar for our engineers, supervisors, aviation technicians, into-plane supervisors and crewmembers. An expert from Faudi Filters also gave a lecture on aviation fuels filtration.

The Department of Transportation and Communication-Office of Transport (DOTC-OTS) granted the Roxas and Davao Depots the International Ship and Port Facility Standard (ISPS) Certifications which are valid for five years instead of one because of the excellent security measures being implemented in the said depots. The depots/terminals which were issued the same certification which is valid for three years are Mandaue Terminal, Bawing, Aparri, Palawan, Mabini, Bacolod and Iloilo depots.

Last September 19, 2006, M/T MMM Ashton, a double hull double bottom vessel was delivered to Petron. This enabled Petron to comply with the requirement of International Maritime Organization (IMO)/Marina on the use of double hull double bottom vessel for transporting fuel products ahead of the said agency's April 2008 schedule.

Petron joined East Asia Response Limited (EARL) as an associate member in 2006. EARL has large equipment and a pool of trained personnel for oil spill response which can be dispatched within hours of activation.

The 10.7 million man-hours without lost time injury were attained in various depots. Pandacan Terminal had the highest with 1.5 million man-hours, followed by Mandaue with 1 million man-hours and Poro with 700,000 man-hours.

Mactan Depot and Mandaue Terminal coordinated with the PNP security task force for the security implementation for the 12th Asean Summit. The refueling of the aircrafts of the advance parties of some participants was conducted to simulate actual fuel loading and test security plans at Mactan Airport.

The personnel of Ormoc, Isabel and Tacloban Depot coordinated with Petron Foundation Inc. in the distribution of goods for the victims of the Guinsagon landslide. Also, personnel from various terminals and depots helped in the oil spill clean-up in Guimaras. The Zamboanga, Davao, Iligan Depot personnel participated in the nationwide tree planting project of the Clean and Green Highway Program of DENR. Almost all depots joined the September Earthday celebrations thru shoreline clean ups, mangrove planting among others.

Information Technology

In 2006, Petron further enhanced the integration of its internal and external business applications by adopting the latest version of the enterprise wide software(SAP System). This resulted into more efficient management of the company's people, processes and technology. The new version provides the platform for initiatives that would enable the use of the Web. It is among the first few companies in the world to implement this latest system.

It implemented the Materials Procurement Optimization System (MPOS) which enables vendors to interact with the company via the Web. The project reduced cycle time and enhance employer and vendor productivity. Several projects were also undertaken to improve the robustness of the Petron communication network as well as reduce costs by taking advantage of the convergence of voice and data technologies.

Also, the installation of the Point –of- Sale (POS) in 51 service stations was completed.

Human Resources

Our Human Resources Management Department (HRMD) implemented programs with the objective of:

- **Enhancing employee awareness of company support, performance, challenges, strategic plans and employee interaction with higher management**

  HRMD conducted employee assemblies which kept the employees informed about significant company developments and enabled them to interact with higher management. In addition to the assemblies, it embarked on the Video Feed Program. Through this program, employees are not only updated on vital company information but are also provided with news briefs, video clips of employees' participation in work related projects, experiences and accomplishments. The information and stories are viewed by all Petron employees in all locations through their computers, PDAs and video capable cellphones. For example, video feeds on Ligtas Guimaras made it possible for employees who were not able to volunteer services to visualize on line the effect of the oil spill on the province's shoreline, clean-up operations and medical outreach programs conducted by the company. The Video Feed Program has received positive feedback and is highly appreciated not only by employees but also by outsiders. In fact, a supplier from New Zealand has also requested a copy of the Point-of-Sales video clip which will be sent to Canada. The program has also been recognized by the International Association of Business Communicators(IABC), Philippines when it conferred two Gold Quill awards for Employee Electronic Interactive Communications and Employee Member Communications.

In addition, a discussion of the company benefits for employees and their dependents has become a regular feature in the official newsletter-Petronews.

- **Enhancing leaders' competencies mindset and management style on goal setting, execution, coaching and relationship building**

  This was achieved through the conduct of training programs on The 21 Irrefutable Laws of Leadership, Trainor's Training and Leading the Service Team.

- **Enhancing employees' competencies**

  This was done through the conduct of various training programs like Customer Oriented Selling, Project Management, Living Competences, An Hour with the Champion, etc. The program on an Hour with the Champion also received the Gold Quill Award of Merit.

- **Enhancing camaraderie among employees and promoting work-life balance**

  To address this goal, several sports tournaments were organized.

  HRMD also conducted the Fuel Service Excellence workshops for the company's business partners i.e dealers, security personnel, receptionists, telephone operators, and building maintenance personnel.

Health, Safety and Environment

In line with the Department of Labor and Employment-Bureau of Working Condition's requirement to have accredited Safety Practitioners in the company, Petron adopted the policy to qualify its contractor and haulers' safety officers as a prerequisite for contractors and haulers to be able to do business with Petron or any of its subsidiaries. This will also ensure compliance with the safety policies of the company.

Petron is also currently implementing the Dupont recommendation which will bring the company's safety practices to best-in-class standards. The project is already 83% complete.

The company conducted various training programs for its employees. These includes:

- Hazard Identification
- Vessel Safety Inspection
- Scenario Based Fire Control
- Basic Fire Control
- Oil Spill Control Training
- Basic Life Support and First Aid
- Basic Safety Training
- Hazmat Emergency Response
- Fire Extinguisher Training
- Fire Truck Driving

It also organized a Safety Orientation for Dealers and Contractors,Truck Safety Seminar for Tank Truck Drivers, Construction Safety and Pollution Control Officers Training for Dealers.

The company's Fire-Fighting Olympics was revived in 2006. The event highlighted Petron's commitment to promote safety and fire prevention among its employees and enhance their skills in effective fire suppression.

Also, a fire fighting competition was organized by Safety and Health Association of the Philippine Energy Sector, Inc (SHAPES) in coordination with the Department of Energy and other government agencies. Our Pandacan Manufacturing Fire Fighting Team participated in this first "Paligsahan sa larangan ng Kaligtasan at Kalusugan".

During the year, various assessment activities were conducted. One is the assessment of different facilities of the company by a consultant based on the requirements of the Fire and Explosion Hazard Management. The result of the assessment will be used in revising the existing prescriptive fire emergency response manuals to a scenario based response protocol. Another assessment implemented is the Workplace Environmental Assessment (WEA). Petron hired the services of SGS Philippines to perform a Workplace Environmental Assessment (WEA) and this was piloted at Gasul Pasig Terminal. Other major depots and terminals will also be assessed. The WEA is a requirement of the Occupational Safety and Health Standard. The objective is to determine the extent of exposure of workers to physical and chemical hazards in the workplace and determine appropriate control measures to eliminate or minimize the hazards.

Emergency preparedness like fire drills, Waterborne Industry Spill Equipment (WISE) drills and safety audits remained to be part of our regular programs. Our Health, Safety and Environment Committee also continued conducting quarterly safety reviews.

Corporate Social Responsibility

For 2006, Petron Foundation Inc (PFI) enhanced its programs on education, continued its involvement in environmental campaigns and responded to the needs of residents of localities affected by different calamities in the country. It continued to engage the Petron employees as volunteers in most of its programs. About 80% of the company's total workforce participated in various programs. They either provide services or financial assistance.

The programs and initiatives undertaken by PFI were:

- **Education**

  Tulong Aral- PFI through its Tulong Aral ng Petron Program which is now on its 5th year has 5,139 scholars in various public elementary schools in Metro Manila and Mindanao. Of the total number of scholars,it is interesting to note that 413 students have outstanding ratings and 55 were awarded first honors. The students are provided books, school supplies, uniforms and meal allowances. As part of this program, teachers are provided training and parents also attend parent effectiveness seminars and livelihood training programs. The program is being implemented together with the World Vision.

  PFI has commissioned the Philippine Psychology Research and Training House to assess the program's impact on the performance of Filipino children in the National Achievement Test. The goal is to improve the students' performance in the test from 57% to 75% average performance which is in line with the League of Corporation Foundation's framework for educational intervention.

  Petron School- In support of the Department of Education's Adopt-A-School Program and in partnership with the Philippine Business for Social Progress (PBSP), Petron continues to put up school buildings in communities where these are greatly needed. In 2006, schools were built in Mindanao, specifically, in Datu Paglas, Sultan sa Barongis, Tawi-tawi, Nasipit, Iligan and Jimenez. This brings the total to 19 schools built since 2002. The construction of some of these schools was funded by a grant from the USAID.

Reading Program- In 2006, the reading programs have benefited 5,389 Grade 4 students and 409 teachers and principals. In partnership with Sa Aklat Sisikat Foundation (SAS), this program was implemented in ten Metro Manila schools and seven schools in Visayas and Mindanao which are included in the Tulong Aral Program. A total of 5,535 books were distributed in these schools.

In coordination with the Department of Education and SAS, the program was likewise launched in 15 schools in Guimaras. It included a two-day training for teachers and school officials. At the end of the activity, the reading carts were turned over to the participating schools.

PFI also started a reading program called the Bright Minds Reading Program for Grade one pupils in Guimaras. A focused reading program was conducted for one month for 50 pupils. Teachers and principals were also trained on how to carry out the program.

It also sponsored the Programang Kaakbay Conference as part of its partnership with SAS. The Gurong Kaakbay builds the technical skills of public school teachers as well as their creativity and leadership skills. The conference was attended by 151 teachers from 56 public elementary schools.

Entrepreneurship Education- As part of our high school entrepreneurship program which is being piloted at the Muntinlupa Business High School (MBHS), we completed the following: the conduct of the Workshop on Learning Materials Development among the faculty of MBHS; the conduct of a workshop to develop a competency-based curriculum; the administration of the Youth Profiling for Starring Careers (YP4SC) among 625 third year high school students; and the development of the competency-based standards and competency-based curriculum for forecourt operations and food service management.

Of the 625 third year high school students of MBHS who took part in the YP4SC, 125 were selected to go through the Youth In Entrepreneurship and Leadership Development (YIELD) Program, an intensive 240-hour on-the-job training program. Under YIELD, an MBHS student was assigned to a Petron service station where he acquired hands-on experience in forecourt operations, food service operations, and back-office management.

Also some of our executives served as mentors to fourth year high school students who participated in the contest for Best Business Plans preparation for the high school level. The MBHS students garnered the 2nd place among the top 17 finalists.

In partnership with HOLCIM Philippines and Education for Youth Entrepreneurship (EYE) Foundation, PFI integrated a Business Week Program at the University of Makati's College of Business Administration program. A similar program was conducted in November for 25 students of Guimaras State College in the municipality of Buenavista. Petron employees served as resource speakers and facilitators of the program.

At the same time, we continued to actively participate in the Junior Achievement of the Philippines Inc (JAPI) mini-company program, where some university students undergo training on managing a company—from the time it is organized until its dissolution. A total of 70 students from five schools in Metro Manila took part in the JAPI business classes, with Petron volunteers serving as their advisers.

- **Environmental Care**

Petron Foundation continued its involvement in environmental campaigns by participating in the programs of the Bataan Integrated Coastal Management Program (BICMP). A significant accomplishment of BICMP for 2006 is the development of the Coastal Zoning Use

Plan which was done in close collaboration with the UNDP International Maritime Organization and the Province of Bataan. This initiative hopes to resolve multiple resource-use conflicts in the coastal and marine areas and shall be the model for the other areas under the Manila Bay Environmental Management Program (MBEMP).

PFI also assisted the BICMP Project Management team in the development of an operational plan, based on the Bataan Sustainable Development Strategy.

It gave support to the construction of the Fitness Trail in the La Mesa EcoPark. It likewise supported the DENR's campaign for the greening of the Philippine highways. And it continued to collaborate with Bataan Refinery with regard to the development of the Bataan Nature Park.

- **Responding to Disaster**

Southern Leyte Landslide

In coordination with the Department of Energy, Department of Social Welfare and Development and the Philippine National Oil Company, PFI took the lead in establishing the Tulong Kapwa Logistics Center for Relief Operations. This was in support of the relief efforts of the National Disaster Coordinating Council.

Petron Foundation in coordination with Gawad Kalinga put up the Energy Village in Fatima, Liloan. The project includes the construction of 100 housing units, multi-purpose center, day care center, Mabuhay house, basketball court and an elementary school which will be situated in Pasanon, San Francisco. At the end of the year, the construction of 50 duplex houses were completed and these were awarded to 100 families. The Multipurpose building and basketball court were also completed. The 12 classroom building which is being built in coordination with the Habitat for Humanity and the Taiwan Economic and Cultural Affair will be finished by the first quarter of 2007. While the construction of the Mabuhay house will start as soon as riprapping is completed.

Guimaras Oil Spill

Petron Foundation coordinated the company's response to the oil spill. This included the shoreline clean-up in 14 barangays through the Cash for Work program; hauling of debris; coordination with various groups such as the Task Force Solar Oil Spill (TF-SOS)/Regional Disaster Coordinating Council, the national, provincial and local governments, media and NGOs; and the preparation of daily updates.

After completing the shoreline clean-up, Petron Foundation started to coordinate the phasing in of alternative livelihood and rehabilitation programs. These include mangrove rehabilitation, sea grass rehabilitation, mariculture or establishment of fish cages, and installation of water systems. Livelihood programs include skills training and capability building programs on priority areas identified by the Comprehensive Relief and Rehabilitation Committee. Short-term livelihood programs such as production of resin-based gift items and production of bamboo-based items were implemented in different communities in the province.

Relief and Rehabilitation for Bicol

Relief goods were distributed in Albay, Camarines Sur and Marinduque. Cash donation from Petron employees, other companies like San Roque Power Corporation, Mindanao I Geothermal, Mindanao II Geothermal, Marubeni Philippines Corporation, KEPCO, West

Japan Engineering, Mt. Apo Bikers Association and other individuals like Ramon Sy and Martin Daza were given for the rehabilitation program for Bicol.

(2) Business of Issuer

(i) Principal products or services and their markets:

Petron's principal business involves the refining of crude oil and the marketing and distribution of refined petroleum products, mainly for the domestic market. It supplies more than one-third of the country's petroleum product requirements. It sells a full range of refined petroleum products, including: industrial fuel oil, diesel, gasoline, liquefied petroleum gas (LPG), jet fuel, kerosene, asphalt, solvent and mixed xylene. Straight-run fuel oil, diesel, and mixed xylene are exported. Lubricating oils and greases are manufactured at Petron's Lube Oil Blending Plant at the Pandacan Terminal. When necessary, some refined petroleum products are imported.

The major markets in the petroleum industry are Reseller, Industrial, Lubes and LPG Trades.

Petron sells its products to both industrial end-users and resellers through a nationwide network of service stations, LPG dealers and retail outlets.

(ii) Percentage of sales or revenues contributed by foreign sales:

Sales Revenue

	Domestic	Exports	Total
2004, in million pesos	134,275	13,081	147,356
2004, in percent	91%	9%	100%
2005, in million pesos	167,703	23,525	191,228
2005, in percent	88%	12%	100%
2006, in million pesos	176,891	34,281	211,172
2006, in percent	84%	16%	100%

(iii) Distribution methods of products or services:

Petron's petroleum products are refined from crude oil at its refinery in Limay, Bataan. From the Bataan Refinery, products are distributed to the various storage terminals and direct consumer accounts nationwide using a fleet of barges and tankers. Products are distributed via pipeline to the Bataan Combined Cycle Power Plant of NPC. From the storage depots, products are hauled by tank trucks to service stations and to direct consumer accounts. Sometimes products are sourced from "rationalized" depots operated with other oil companies.

Sales to customers within the terminal's tributary area are withdrawn by tank trucks.

Lubes and greases in various packages are also transported via container vans to bulk plants and terminals outside Metro Manila. These are sold through service stations and sales centers.

In the LPG trade, Petron has a nationwide network of retail dealerships and outlets. To guarantee convenience for the customer in purchasing Gasul and accessories, retail outlets are usually situated in the vicinity of residential areas or at service stations. Also, we have "*Tawag Lang Centers*" which the customers can call to place their orders, and these centers will ask the dealer nearest the residence or location of the customer to deliver the product.

(iv) New products or services:

New Products

- **Petron Carbon Flush -** a non-toxic, non-flammable and biodegradable fluid intended for de-carbonizing and cleaning air intake and exhaust systems of diesel-powered engines. It is intended to reduce black smoke emissions by allowing the carbon deposits, soot and scales to loosen up and flow harmlessly out of the system as exhaust gas.

- **Flushing Base** – a mineral oil-based compound designed to remove internal engine deposits and can be used for general flushing operations.

- **Slideway Oil** – a mineral-based oil designed specifically for the lubrication of slides and ways of various machine tools to avoid stick-slip and frictional occurrences during operation.

Product Enhancements

- **New Generation Diesel Max** – an improved version of Diesel Max that makes use of a new generation additive technology. On top of the multifunctional additive that provides unsurpassed detergency characteristics and smoke control, the new formulation incorporates an additive system to improve diesel burning quality and fuel economy and also protects the injection system from wear.

- **Enhanced Formulation of Grease Products -** improved the quality of existing Petron grease products with respect to baseoil viscosity, rust and corrosion protection, anti-wear performance, water resistance and oxidation resistance, in line with the Grease Plant Rehabilitation Project.

(v) Competition

Petron operates in a deregulated oil industry, where the major players and the other entrants compete for market share. Though pricing remains to be a primary driver of sales in all sectors, the recent years have already seen a trend towards total customer solutions which differentiate the industry leaders from mere industry players.

This industry is very much affected by the decreasing oil demand, high crude prices, tight competition and by the public perception of fuel prices plus strict environmental requirements and a more value-conscious breed of customers.

Low Oil Demand- The country's total consumption of petroleum products decreased by 7.5%. The decline in oil demand can be attributed to the effect of higher oil prices. While consumption is projected to improve in the coming years, the recently approved Biofuels Bill promoting the use of biodiesel and bioethanol will put pressure on the demand for oil.

Price of Crude- Crude prices continued to be volatile in 2006 due to persistent geopolitical tensions over Iran and North Korea, worsening conflict between Israel and Hezbollah, and the shutdown of the largest US oil field Prudhoe Bay in Alaska. The average international spot price of Asian Dubai crude increased to $61.52 in 2006 from $49.54 in 2005. Higher global oil demand, plans to boost strategic reserves of US and China, supply disruptions due to persistent troubles in the Middle East, and OPEC production cuts are expected to keep prices high in 2007.

Growing Industry Competition- With deregulation, competition in the industry has become borderless with product imports coming into the market at the same tariff as crude, i.e., no preferential duty for refiners. The closure of Caltex' refinery in the latter part of 2003 and its conversion to a product import terminal confirms the magnitude of pressure in the industry. This would put further pressure on the efficiencies of remaining asset-heavy refiners like Petron.

In addition, although the new players' market share slightly decreased to 14.6% in 2006 from 15.1% of same period last year, they have gained a foothold of the LPG market capturing about 40.7% of total sales. Moreover, they have been very aggressive in their marketing efforts by establishing biofuel retail stations in Metro Manila and offering minimal investment capitalization for the installation of auto-LPG conversion kits.

Public Perception on Fuel Pricing- Despite a series of fuel price reduction in 2006, the public's understanding of fuel pricing remains limited to recovery of direct costs (e.g. recovery of cost of crude). The public should appreciate that oil companies are commercial entities that need to obtain a reasonable return on investments to keep them viable over the long-term.

Petron participates in the reseller (service station), industrial, lube and LPG sectors, through its network of service stations, terminals & bulk plants, dealers, and distributors nationwide. Its competitors are Pilipinas Shell Petroleum Corporation, Chevron, Phils. (formerly Caltex Philippines), Total Philippines Corporation, Flying V, SeaOil Petroleum Corporation and other new players. Historical data shows that Petron has effectively gained and protected its market leadership in the industry with a market share of 45.5% relative to Shell and Chevron and 38.8% considering the total industry. Although its domestic sales were lower than the 2005 level, it outperformed industry which contracted by 7.5%.

Petron has the strengths in terms of organization, technology, assets, resources and infrastructure. It has continuously developed and adopted initiatives that will improve operational efficiencies; managed costs and risks; maximized utilization of its assets and opportunities like tapping new markets, engaging in new businesses, etc. Some of its customer initiatives include the establishment of customer satisfaction index to form part of the company's key performance indices. Employee participation in identifying and solving problems in the front-line level, thru the mystery shopper programs, was encouraged.

(vi) Sources and availability of raw materials and the names of principal suppliers

Arab crude continue to account for bulk of total crudes purchased in 2006, with the remaining crudes limited to Far East crudes like Tapis and Miri. Our supply agreement with Saudi Aramco which commenced in March 1994 and is in effect for 20 years, allows Petron to process Arab crudes up to 90 % of its total requirements. Our crude supply agreement with Petronas is renewed annually.

We have renewed our agreement with Petronas for the purchase of LPG. It has been our major LPG supplier for the last six years.

We also have term supply agreements for the export of mixed xylene, reformate and straight run fuel oil (SRFO).

We also have contracts with shipping companies to ensure availability of vessels for our crude shipments.

(vii) Dependence on one or a few major customers and identity of any such major customers

National Power Corporation (NPC) sales accounts for roughly 8.2% (from 9.2% in 2005) of total Petron sales as of end-2006. Loss of this account will impact on sales volume.

(viii) Transactions with and/or dependence on related parties

Since 1993, Petron has been leasing from PNOC certain parcels of land where its refinery and most of its bulk plants, terminals, and service stations are located. Petron has also been leasing from New Ventures Realty Corporation some parcels of land where some of its depots, terminals and many service stations are located. Under the Retail Trade Liberalization Law, Petron is allowed to engage in direct retail of its fuel products thru its subsidiaries, namely, PMC and PFC. PMC is also leasing service station sites from NVRC.

Majority of the insurance policies of Petron for 2006 were placed with Petrogen Insurance Corporation.

Also, in 2006, Petron purchased most of its crude under the Crude Oil Supply Agreement with Saudi Aramco, a company wholly owned by the Saudi Arabian Government.

(ix) Patents, trademarks, licenses, franchises, concessions, royalty agreements

(a) Trademarks

Approved. Petron has trademark registrations for a term of 20 years for its Rev-X, AS, Petrogrease, Cablekote, Gearkote, Gearfluid, Gasulette, Gasulite, Gasulgrille, Gasul, Marinekote, LPG Gasul Cylinder 50 kg., Gasul and Device, LPG Gasul Cylinder 11 kg., Petron STM, Petron Autokote, GEP, Regatta, Petron Old Logo, Hypex, Extra, Petron Old Logo (Tradename), 2T, Turnol, Petromar HD, Spinol, Airlube, Hydrotur, Petromix, Voltran, Stemol, Petrocyl 680, Printsol 600, Overglide, Grease Away, Petrokut, Petron Railroad Extra, Rubbex, Petron Dust Stop Oil, Oil Saver, Petron HD, Petron HD3, DCL 100, Milrol, Petropen, Petron GST, Petron with XCS, With XCS, Super DC, LPG Gasul Cylinder 2.7 kg. Petromul CSS-1, New Petron Logo, Power Booster, Zerflo, Petron XD3, TDH 50, Petron 2040, Automatic Transmission Fluid, Petrotherm 32, Petrokote, Petrosine, Petron HDX, Petron TF, Petron, and Ropgriz.

Treats & Device, Rev-X All-Terrain, Petron Gasul 11-kg POL-VALVED Cylinder, Ultron Speed, Ultron Rallye, Rev-X Trekker, Rev-X Hauler, Rev-X HD, Bull's Eye, Ultron Extra, Sprint 4T, Xpert Diesel Oils, Penetrating Oil are registered for a term of 10 years.

Pending. Petron has pending applications for registration of the following trademarks: Ultron and Device, Lubritop, Antimist, Grease Solve, Process Oils, 2T Motorcycle Oil, Petromate with Logo, Powerburn 2T, Gasulito with Stylized Letter "P", Gasulito (7kg.) Container, Molygrease, Petron GX, Asphaltseal, Cable Lube, Solvent 3040, Adgas, Blaze, "Your Friend on the Road", Ultron Race, Ultron Touring, Clean 'n Shine, Ultimate Release from Engine Stress, Xpert sa Makina Express ang Kita, It's Oil You Need, Pchem, Gas Saver, Lakbay Alalay, 2T Enviro with Oil Drop, Rover, Petron Freeport Corporation, Petron Marketing Corporation, Fuel Success, Xtra, Power for Xtra Miles, Petron Marine HD Oil for Fishing Boat, Petron Farm Trac Oil for Farm Equipment, PetronConnects, Treats (for bottled water), Fuel, Fuel Hope, Fuel Trust, Fuel

Experience, Fuel Drive, Fuel Excellence, Fuel Efficiency, Pure Distilled Drinking Water, Fuel X Fuel Customer, Xtend, Tulong Aral ng Petron & Device, Tulong Aral, and Fuel Challenge.

(b) Copyrights

Petron has copyrights for its 7-kg LPG container, Gasulito with stylized letter "P" and 2 flames, for Powerburn 2T, and for Petron New Logo (22 styles). Copyrights endure during the lifetime of the creator and for 50 years after his death.

(x) Need of government approval of principal products or services

Government approval of Petron products and services is not generally required. Petroleum products refined at the Petron Bataan Refinery conform with specifications under the Philippine National Standard. Importations of petroleum products and additives are reported to the Department of Energy (DOE), in accordance with the Oil Deregulation Law. Clearances are secured from concerned government authorities for importations of restricted goods. Supply of products or services to government and government agencies undergo bidding process in accordance with law.

(xi) Effect of existing or probable government regulations on the business

Biofuels Act of 2006. Aiming to reduce the country's dependence on imported fuel, the biofuels law signed in January 2007 mandates the use of 5% bioethanol blend in gasoline within two years. Within four years from the effectivity of the Act, the National Biofuel Board or NBB (composed of key government agencies like DOE, DOST, DA) is empowered to determine the feasibility of increasing the bioethanol blend to 10%. Meanwhile, for diesel engines, a 1% biodiesel blend is mandated within three months. The NBB is also empowered to determine the feasibility of increasing it to 2% within two years.

In compliance, the company will be investing in CME(coco methyl ester) injection systems at the refinery and depots, and other necessary facilities for ethanol blending. These investments will enable us to produce the compliant fuels.

Clean Air Act. Petron invested in a Gasoil Hydrotreater Plant and in an Isomerization Plant to enable it to produce fuels compliant with the standards set by law.

(xii) Estimate of the amount spent during each of the last three fiscal years on research and development activities:

Every initiative or program the company undertakes would have a research and development aspect to it but it is not always a distinct component. Often, this element is integrated into the other aspects or operational levels of our program.

(xiii) Costs and effects of compliance with environmental laws

Compliance with the various environmental laws (e.g. Clean Air Act, Clean Water Act) definitely entails costs and additional investments on the part of the company, resulting in higher production costs and operating expenses.

(xiv)Total number of employees

The company has a total of 1,242 employees as of December 31, 2006. This is broken down as follows: Chairman, President, six (6) Vice Presidents, 785 Managerial, Professional and Technical (MPT) employees, and 449 Rank and File employees. We anticipate that in 2007, we will have 1,305.

Petron has Collective Bargaining Agreements with its three unions, namely: (a) Bataan Refinery Union of the Philippines (BRUP); (b) Petron Employees Labor Union (PELU); and (c) Petron Employees Association affiliated with the National Association of Trade Unions (PEA-NATU). The CBA with BRUP covers the period May 1, 2004 to December 31, 2007. For PELU, the CBA is in effect from July 1, 2004 to December 31, 2007. The CBA with PEA-NATU was renewed on January 1, 2006 and will expire on December 31, 2008.

There were no strikes in the past three (3) years. However, the BRUP filed a Notice of Strike with the National Conciliation and Mediation Board at its Regional Office in San Fernando, Pampanga on July 6, 2005. The complaint was about unfair labor practices including erosion of the bargaining unit, union busting and arbitrary dismissal. The allegation of the union followed after the completion of the Refinery's Offsites Automation Project. This project included the installation of labor-saving devices and as a natural consequence, some positions were declared redundant. On July 11, 2005, the Secretary of the Department of Labor and Employment certified the dispute for compulsory arbitration by the National Labor Relations Commission (NLRC) and indicated that any strike or lockout is prohibited and that the employees were directed to return to work in case the strike is carried out.

As part of the company's compensation package, it adopted the Rewarding Excellence through Alternative Pay Program (REAP) which is based on the achievement of the company's annual business goals.

In addition to the statutory benefits, the company provides hospitalization insurance wherein both the employee and the company share in the payment of the insurance premium; life insurance; vacation, sick and emergency leaves; computer, company and emergency loans subject to applicable interests; and provident fund wherein the company matches the contribution of the employee.

Major Risks Involved

Risk Management Framework & Process

Petron Corporation follows an enterprise-wide risk management framework for identifying, mapping and addressing the risk factors that affect or may affect its businesses.

The company's risk management process is a bottom-up approach, with each division mandated to conduct regular assessment of its risk profile and formulate action plans for managing identified risks. As Petron's operation is an integrated value chain, risks emanate from every process and some could cut across divisions. The results of these activities flow up to the Management Committee and eventually, the Board through the company's annual Business Planning process and quarterly divisional Management Reviews.

Oversight and technical assistance is likewise provided by corporate units with special duties, such as the Financial Analysis, Planning & Risk Management Department, the Management Investment Committee, the Health, Safety and Environment Management Committee and the Internal Audit Department.

Major Risks

The company classifies a risk as a major risk if it assesses the risk event to both have a relatively high probability of occurring and a substantial adverse impact on the company if the event did occur. The major risks that the company managed in 2006 were substantially the same as those in the previous year since there were no fundamental changes in the nature of the company's operations. These risks were the following:

- Foreign exchange risk arising from the difference in the denomination of majority of revenues (i.e., pesos) against that for the bulk of costs (US dollars). Changes in the foreign exchange rate would result in the revaluation of key current assets and liabilities, and could subsequently lead to financial losses for the company.
- The risk of substantial disruptions in the company's operations caused by accidents, process or machinery failure, human error or adverse events outside of human control. These disruptions may result to injury or loss of life, as well as financial losses should these disruptions lead to product run-outs, facility shutdown, equipment repair or replacement, insurance cost escalation and/or unplanned inventory build-up.
- Profit margin and cash flow risk arising from fluctuations in the relative prices of input crude oil and output oil and petrochemical products. Changes in output and input prices, particularly when mismatched, may produce significant cash flow variability and cause disruptions in the company's supply chain, as well as higher financing expenses.
- Regulatory risk, arising from changes in government policies and regulations that may adversely affect the financial viability of the company, either directly or indirectly.

The company has determined that none of the risk factors faced by any of its subsidiaries would be a major risk - these have either a low probability of occurring and/or has insignificant potential impact to Petron. Thus, subsidiary-specific risks were considered in the company's risk management process but since these are relatively minor, have not been included in this report.

Management of Major Risks

- Foreign exchange risk
  - The company hedges its dollar-denominated liabilities using forwards and the generation of dollar-denominated sales. It avoids the creation of risk from derivative speculation by limiting the use of forwards to 100% of the value of the underlying dollar-denominated liabilities net of dollar-denominated assets.
  - An SAP-based financial software program is used to track dollar-denominated assets and liabilities on a daily basis and the resulting potential foreign exchange loss caused by these. This allows almost real-time awareness and response to contain losses posed by foreign exchange exposure.

- Risk of operational disruptions
  - The risk of operational disruptions is most relevant to the company's refining unit since disruptions in the Refinery can have severe and rippling effects.
  - The Refinery Division has been implementing programs designed to directly address the avoidance of operational disruptions through effective maintenance practices and the inculcation of a culture of continuous improvement.
  - The company has a corporate-wide safety program that likewise addresses the risk of operational disruptions.

- Profit margin and cash flow risk
  - Margin hedging strategies are used for some dollar-based contracts in order to eliminate the risk of profit margin compression due to changes in crude and product prices. A margin hedge simultaneously fixes the future dollar prices of Dubai crude oil and that of a selected product (contracted to be sold at the future date) manufactured from the crude.
  - The company endeavors to arrange long-term contracts for some of its fuel and petrochemical products whenever these are financially attractive. Long-term sales contracts provide a partial hedge on future cash flow uncertainty.
  - The company makes use of a cash flow projection software that enables it to proactively respond to potential future cash flow imbalances. It likewise maintains access to credit lines in excess of typical requirements so that funds can be readily tapped in case of a cash flow squeeze.

- Regulatory risk
  - The company maintains strong lines of communication with its various counterparties in government and in the public arena, in both local and national levels. The company uses these lines of communication to identify potential risk factors and respond to these in a proactive manner.
  - The risk of non-compliance to environmental standards mandated by the Clean Air Act was virtually eliminated with the company's US$100 million investment in an LVN Isomerization Unit and a Gas Oil Hydrotreater, which became operational in 2006.

Apart from the major risks identified above, the company has also put focus on the risk of oil spill. This risk was not considered as a major one prior to 2006 because while it has a high impact, the probability of its occurrence was low. However, with the Guimaras oil spill incident in August 11, 2006, the company has now prioritized this risk. A contingency plan to address oil spill incidents in domestic and international waters had been developed. Petron is also expediting the shift to the use of double hull domestic vessels, and sought membership in Oil Spill Response and East Asia Response Limited, a Singapore based organization, which is owned by international oil companies and is the only one in the world available to provide immediate assistance to respond and to contain oil spill incidents. The public relations and communications programs related to this risk had also been strengthened.

(B) Description of Property

Petron owns the largest petroleum refinery complex in the Philippines located in Limay, Bataan. This refinery has a crude distillation capacity of 180,000 barrels per day (BPD). It has three Crude Distillation Units, a Vacuum Pipestill Unit, a Thermofor Catalytic Cracking Unit, a Continuous Catalyst Regeneration Platformer Unit, a Powerformer Unit, two Naphtha Hydrotreaters, two LPG Treaters, an Isomerization Unit, a Mixed Xylene Plant, a Kerosene Merox Treater, a Kero Hydrosweetener, three Gas Oil Hydrotreater Units, a Sulfur Recovery Unit, a Caustic Regeneration Unit, Waste Water Treatment Facilities, seven Steam Generators, five Turbo Generators, Flare and Safety Relieving Facilities, Bulk Asphalt Receiving Facilities, several crude storage tanks, as well as several refined petroleum products storage tanks. It has its own piers and other berthing facilities one of which can accommodate very large crude carriers.

Petron also operates an extensive network of terminals and bulk storage and satellite facilities and LPG plants which are located in Luzon, Visayas and Mindanao. Its major terminals and plants are in Limay, Bataan; Pandacan, Manila; Rosario, Cavite; Ugong, Pasig City; Mabini, Batangas; Poro Point, San Fernando, La Union; Mandaue City; Lapuz, Iloilo City; Bacolod City; Tagoloan, Misamis Oriental; Sasa, Davao City; and Zamboanga City. Its bulk plants and sales offices in Luzon are located in Aparri, Cagayan; Calapan, Oriental Mindoro; Pasacao, Camarines Sur; Legaspi City, Albay; Puerto Princesa, Palawan; San Fernando City, Pampanga, and Navotas, Metro Manila. In the Visayas and Mindanao, the bulk plants are in Amlan, Negros Oriental; Culasi, Roxas City; Linao, Ormoc City; Anibong, Tacloban City; Isabel, Leyte; Tagbilaran City, Bohol; Iligan City; Jimenez, Misamis Occidental; Bula and Bawing, General Santos City and Nasipit, Agusan del Norte.

Petron has airport installations at the JOCASP, NAIA, Pasay City; Laoag City; Mactan, Cebu; Iloilo and Davao City. Since Petron is no longer qualified to own the parcels of land where the Bataan Refinery, the terminals, the bulk plants and the service stations are located, these lands are now leased from the Philippine National Oil Company (PNOC) and from New Ventures Realty Corporation (NVRC) on 25-year leases, which are renewable. Petron's lease agreements on those lands owned by private persons vary as to their terms and conditions, including the period of lease.

The lease agreements with PNOC is until August 2018. Lease charges on refinery facilities escalate at 2% a year, subject to increase upon reappraisal. Lease payments amounted to P147 in 2006 and P145 million in 2005.

Petron anticipates that it will lease desirable lots from NVRC and third parties to be developed as services stations in the next twelve months.

(C) Legal Proceedings

In 2006, Petron was involved in certain litigation some of which are material as this term is understood under the law. These are:

1. **Petron Corporation v. Commissioner of Internal Revenue and BIR Regional Director of Makati, Region 8**
   CTA Case No. 5657
   Court of Tax Appeals
   Date Filed: July 7, 1998

   Commissioner of Internal Revenue v. Petron Corporation
   CA -GR No. 55330
   Court of Appeals
   Date Filed: October 1999

   Background: In April 1998, the BIR demanded from Petron payment of alleged delinquent specific taxes, inclusive of surcharges and interest for the years 1993 to 1997. Protesting the collection inasmuch as its excise tax liabilities had been fully paid through the use of validly issued Tax Credit Certificates (TCCs), Petron elevated its protest to the Court of Tax Appeals (CTA) in July 1998. The CTA ruled in favor of Petron. In 1999, the BIR Commissioner elevated this ruling to the Court of Appeals where it is still pending.

   Relief sought on Appeal: The BIR seeks a reversal of the CTA decision and prays for judgment ordering Petron to pay P1,107,542,547.08 in excise tax liabilities for 1993-1997 inclusive of surcharges and interest, plus 25% surcharge and 20% annual interest from April 22, 1998.

   Status: The Court of Appeals issued a resolution suspending resolution of the case until the termination of the DOF investigation on the TCCs assigned to Petron.

Exposure: P1,107,542,547.08 plus 20% annual interest from April 22, 1998.

Likelihood of resolution against Petron: Remote

2. **Petron Corporation v. Commissioner of Internal Revenue (CIR)**
   CTA Case No. 6136
   Court of Tax Appeals
   Date Filed: July 10, 2000

   Background: In November 1999, the BIR assessed a deficiency tax of P651,334,263.92 (inclusive of interest, charges and penalties) based on a batch of cancelled Tax Debit Memos (TDMs) issued against TCCs that were assigned and transferred to Petron and used by it to pay excise taxes. The Department of Finance (DOF) One-Stop-Shop and Duty Drawback Center declared that these TCCs were fraudulently issued and transferred.

   Protesting this assessment, Petron filed the Petition for Review (with Motion to Stop Collection of Deficiency Excise Taxes, Surcharges and Interest) before the CTA.

   Status: The Second Division of the CTA promulgated its Decision on August 23, 2006 denying the instant Petition for Review for lack of merit. Petron is ordered to pay the respondent the amount of P580,236,552.67, representing deficiency excise taxes for the taxable years 1995 to 1997 plus 20% delinquency interest per annum computed from December 4, 1999 until the amount is fully paid. With the denial of its motion for reconsideration, Petron has filed its appeal with the CTA *en banc*.

   Exposure: P651,334,263.92 plus 20% interest from November 1999.

   Likelihood of resolution against Petron: Considering the adverse decision against a similar case involving Pilipinas Shell, a denial of the appeal by the CTA en bank is likely. However, we still feel that a final resolution of this case by the Supreme Court adverse to Petron is unlikely.

3. **Petron Corporation v. Commissioner of Internal Revenue**
   CTA Case No. 6423
   Court of Tax Appeals
   Date Filed: April 2002

   Background: In January 2002, the BIR issued a tax deficiency assessment against Petron for the total amount of P739,003,036,32 (inclusive of interest and charges) since the TCCs and TDMs used to pay the excise tax liabilities had been identified as cancelled by the DOF One-Stop-Shop and Duty Drawback Center.

   In April 2002, Petron filed a Petition for Review with a prayer for a TRO with the Court of Tax Appeals.

   Status: The CIR rested its case in May 2004. However, on October 4, 2004, the CTA, upon motion of the CIR, and over the objection of Petron, reopened the case and set it for hearing for presentation of further evidence by the CIR. Petron filed a Memorandum and the case is now deemed submitted for Decision.

   Exposure: P739,003,036,32 plus 20% interest per annum from January 2002.

   Likelihood of resolution vs. Petron: Remote

4. **People of the Philippines v. Antonio P. Belicena et al.**
Sandiganbayan (4th Division)
Date Filed: April 6, 2000 – August 2002

Background: Former Petron officials are charged with violations of the Anti-Graft and Corrupt Practices Act for having allegedly conspired with former officials of the DOF One-Stop-Shop and Duty Drawback Center, BIR and the Bureau of Customs (BOC) and with private individuals to defraud the government by accepting fraudulently issued TCCs and thereafter, by using these TCCs in payment of taxes. Due to the prolonged delay in submitting the results of the reinvestigation by the Office of the Special Prosecutor, the Sandiganbayan on August 20, 2001, dismissed 18 of these cases. However, on February 2, 2002, the Sandiganbayan set aside the dismissal. On December 12, 2003, the Sandiganbayan denied the accused's motion for reconsideration.

Status: On March 22, 2004, invoking their right against double jeopardy, 2 former Petron officials already arraigned, filed their Petition for Certiorari with the Supreme Court to nullify the setting aside of the dismissal. In the meantime, reinvestigation of the cases has been terminated and the Ombudsman has resolved to pursue prosecution.

Exposure: As against Petron, the civil aspect of these cases is already in the civil cases mentioned above.

Likelihood of resolution vs. Petron Officers: Remote

5. **Special Presidential Task Force 156 v. Antonio P. Belicena, et al.**
Ombudsman
Date Filed: March 18, 2003 – January 30, 2004

Background: A number of Petron officers and employees are charged before the Ombudsman for having allegedly conspired with former officials of the DOF One-Stop-Shop and Duty Drawback Center and with private individuals in committing plunder, violation of the Anti-Graft and Corrupt Practices Act and Estafa for the fraudulent issuance of TCCs to several corporations and their subsequent fraudulent transfer to Petron.

Status: All these cases are now deemed submitted for resolution by the Office of the Ombudsman following submission by the respondents of their counter-affidavits and/or after the Special Presidential Task Force 156 created to investigate and prosecute the cases filed its Reply Affidavit. It should be noted that in one case, notwithstanding the fact that the alleged fraudulent TCCs were not used by Petron to pay for its own tax obligations, nonetheless conspiracy charges for fraudulent acts were filed against a Petron officer.

Exposure: As against Petron, the civil aspect of this case is already in the civil cases mentioned above.

Likelihood of resolution vs. Petron Officers: Remote

6. **Petron Corporation v. Mayor Tobias Tiangco**
Supreme Court, 2nd Division
Date Filed: July 17, 2003

Petron Corporation v. Mayor Tobias M. Tiangco and Municipal Treasurer Manuel T. Enriquez

Regional Trial Court of Malabon
Date Filed: May 20, 2002

Background: On March 4, 2002, the Municipality of Navotas assessed Petron the amount of P10,204,916.17 as business tax on the sale of diesel fuel at Petron depot at the Navotas Fishport. Petron questioned the assessment in an action for Cancellation of Assessment of Deficiency Taxes before the Regional Trial Court of Malabon. The RTC rendered its Decision dated 5 May 2003 dismissing Petron's complaint and ordering Petron to pay the business tax assessed.

On July 17, 2003, Petron filed a petition for review with the Supreme Court with a prayer for a temporary restraining order (TRO).

Relief sought: Reversal of the RTC Decision and the cancellation of the questioned assessment of the Municipality of Navotas.

Status: The Supreme Court issued a TRO against the Mayor and Municipal Treasurer of Navotas on August 6, 2003 which enjoined the latter from closing Petron's Navotas oil depot. The petition is now deemed submitted for decision with the parties' submission of their respective memoranda.

Exposure: If this case is resolved against Petron, the latter will have to pay business tax on its sale of diesel fuel at the Navotas Fishport.

Likelihood of adverse decision: Possible

7. **Petron Corporation v. City Council of Manila, et al.**
Regional Trial Court of Manila
Date Filed: April 25, 2003

Background: The City Council of Manila, citing concerns of safety, security and health, passed City Ordinance No. 8027 reclassifying the areas occupied by the Oil Terminals of Petron, Shell and Caltex from Industrial to Commercial, making the operation of the Terminals therein unlawful. Simultaneous with efforts to address the concerns of the City Council with the implementation of a Scale Down Program to reduce tankage capacities and joint operation of facilities with Shell and Caltex, Petron filed this petition to annul city Ordinance No. 8027 and enjoin the City Council of Manila, as well as Mayor Joselito Atienza from implementing the same.

Relief sought: Nullification of Ordinance No. 8027

Status: A status quo order is in effect and the case is under mediation proceedings. Recently, the City of Manila approved the Comprehensive Land Use Plan and Zoning Ordinance (CLUPZO) that allows Petron a 7-year grace period. The passage of the new General Zoning Ordinance effectively repealed Manila Ordinance No. 8027 and is in fact now being implemented by the City of Manila. With the repeal of Manila Ordinance 8027, our cause of action against the City of Manila in the aforesaid case was rendered moot and academic

Exposure: No monetary claim. Adverse decision would mean closure of the terminals at Pandacan.

Likely Outcome: This case is likely to be dismissed for the reason cited above. However, Petron intends to file another case to question the validity of the CLUPZO.

PART II – SECURITIES OF THE REGISTRANT

(A) Market Price of and Dividends on Registrant's Common Equity and Related Stockholder Matters

(1) Market Information

The registrant's common equity is principally traded at the Philippine Stock Exchange. The high and low sales prices for each period are indicated in the table below:

	Highest Close		Lowest Close	
Period	Price	Date	Price	Date
2006				
1st Quarter	5.00	12& 17 Jan-06	4.40	2-Jan-06 3,28,30,31-Mar-06
2nd Quarter	5.00	8-May-06	3.45	14 & 15 June-06
3rd Quarter	4.45	31-Jul-06	3.75	17-Jul-06 25-Aug-06 12-Sep-06
4th Quarter	4.35	03 & 06-Nov-06	3.90	13-Nov-06
2005				
1st Quarter	4.50	9-Mar-05	3.20	03 & 06-Jan-05
2nd Quarter	3.75	4-Apr-05	2.95	30-Jun-05
3rd Quarter	3.35	12-Aug-05	2.65	4-Jul-05
4th Quarter	4.65	8-Dec-05	3.15	5-Oct-05

The total number of stockholders as of December 31, 2006 is 188,198. Price as of last trading day of the year, December 29, 2006, was P4.10 per share.

As of March 31, 2007, the total number of stockholders is 186,517 and the stock price was P4.70

(2) Holders

List of Top 20 Stockholders
As of March 31, 2007

Rank	Name	Nationality	No. of shares	%
1	Philippine National Oil Company	Filipino	3,750,000,007	40.00
2	Aramco Overseas Company B.V.	Netherlands	3,750,000,006	40.00
3	PCD Nominee Corp.	Foreign	578,918,797	6.18
4	PCD Nominee Corp.	Filipino	570,196,008	6.08
5	Home Development Mutual Fund	Filipino	18,830,091	0.20
6	Ansaldo, Godinez & Co. Inc. FAO Mark V. Pangilinan	Filipino	8,000,000	0.09
7	Siao Tick Chong	Filipino	7,500,000	0.08
8	Ernesto Chua Chiaco &/or Margaret Sy Chua Chiaco	Filipino	6,000,000	0.06
9	Marciano V. Pangilinan	American	5,000,000	0.05
10	Aristeo Lascano Castillo	Filipino	4,145,000	0.04
11	Paul Gerald B del Rosario	Filipino	3,697,000	0.04
12	Raul Tomas Concepcion	Filipino	3,504,000	0.04
13	Sonny Ico Parayno	American	2,613,000	0.03
14	Ching Hai Go &/Or Martina Go	Filipino	2,500,000	0.03
15	Aristeo L. Castillo	Filipino	2,326,500	0.02
16	China Banking Corporation	Filipino	2,287,500	0.02
17	Allied Banking Corporation	Filipino	2,145,000	0.02
18	Conrado S. Chua Sr.	Filipino	2,130,000	0.02
19	Shahrad Rahmanifard	Iranian	2,000,000	0.02
20	Frank Chua &/or Genevieve Lim Chua	Filipino	1,453,588	0.02

(3) Dividends

Petron's dividend policy is to declare as dividends out of the company's unrestricted retained earnings at least 25% of its unappropriated net income (after taxes) for the prior fiscal year, payable either in cash, property or shares. The Board shall determine, by resolution, the exact amount, date and shareholders entitled to such dividends.

On May 19, 2006 , the company's Board of Directors declared a cash dividend in the amount of P0.10/share. Stockholders on record as of June 2, 2006 were paid their dividend on June 29, 2006.

The previous year, on May 12, the Board also declared a cash dividend of P0.10 per share. All stockholders on record as of May 26, 2005 were entitled to the dividend and the payment date was June 21, 2005.

(4) Sale of Unregistered or Exempt Including Securities Constituting an Exempt Transaction

The company did not sell any securities within the past three years which were not registered under the Code nor did it sell reacquired securities or new issues or sell securities issued in exchange for property, services, or other securities, and new securities resulting from the modification of outstanding securities.

(B) Description of Petron's Shares

The registrant's securities consist entirely of common stock with par value of P1.00 per share. Total common shares are 9,375,104,497 which are also voting shares.

(C) Stock Ownership Plan

The Stock Ownership Plan (SOP), a one-time program, adopted in 1994 by PNOC, the selling shareholder in Petron's Initial Public Offering, was not a stock option plan which had to be approved by the SEC. Rather, it was a special secondary sale of Petron's shares to a selected group of persons. Entitlement of shares at the listing price of P9.00 per share was made equivalent to the employee's base pay factored by his/her service years with Petron. Petron's Executive Officers, except the Chairman, the President and the Vice President for Corporate Planning, were entitled to own Petron shares under this SOP.

PART III – FINANCIAL INFORMATION

(A) Management's Discussion and Analysis or Plan of Operation.

Financial Condition and Results of Operations

(For convenience, U.S. dollar information in the following discussion has been translated into Philippine pesos at the exchange rate of ₱ 49.045 to US$1.00, the Philippine peso - U.S. dollar rate as quoted by the Philippine Dealing System as of December 31, 2006.)

Results of Operations

2006 vs. 2005

During the year 2006, the Company posted a net income of **₱ 6.02 billion**, almost at the same level as the ₱ 6.05 billion the year before. The flat growth from last year was driven mainly by inventory losses estimated at ₱ 1.6 billion (net of tax) brought about by the unprecedented drop in crude prices which started in the third quarter. Selling prices went down as regional product prices fell, significantly compressing the company's margins.

Aggregate **sales volume** reached **52.2 MMB** as exports increased by almost 3.0 MMB from 2005 level to compensate for lower domestic demand (by 2.4 MMB).

Net Sales of **₱ 211.7 billion** showed an 11% (₱ 20.2 billion) improvement from the ₱ 191.5 billion sales during the comparative period the year before. Higher MOPS prices (2006 average: ₱ 21.58/ lt. vs. 2005 average: ₱ 19.28/lt.) as well as the upward adjustments in domestic pump prices by an average of ₱ 2.66 per liter accounted mostly for the increase in revenues. This was augmented by the 1% (.5 MMB) incremental sales volume.

Cost of Sales (COS) stood at **₱ 197.5 billion**, up 11% (₱ 20.3billion) from the ₱ 177.2 billion reported a year earlier. This was traceable primarily to the spike in FOB per barrel of crude that went into cost (2006 average: $62.08 vs. 2005 average: $48.72) partly tempered by the appreciation of the peso against the dollar (2006 average: ₱ 51.30 vs. 2005 average: ₱ 55.07).

Gross Margin per liter of **₱ 1.71** and **gross margin rate** of **6.7%** were lower than last year's ₱ 1.74/ 7.5%. The recorded increase in pump prices and MOPS prices during the first half of 2006 was significantly reduced by successive rollbacks that started in the third quarter brought about by the rapid drop in crude prices and corresponding fall in regional product prices. On the other hand, duty paid landed cost (DPLC) of crude remained high with Petron holding an average of 28 days in crude inventory and 25 days in product inventory.

Refinery Operating Expenses (which form part of cost of sales) summed up to **₱ 3.2 billion,** 6% lower than last year's level. The reduced opex compared to the previous year was attributable largely to lower maintenance and repairs expenses. In addition, there was no provision for obsolescence recognized for storehouse materials this year and existing allowance was reduced to consider significant movements in materials/items considered obsolete before. This was influenced mainly by the change in operating strategies with the installation of new Units, ongoing major projects and the advent of future expansion projects.

Peso per liter of crude processed declined to **₱ 0.39 f**rom ₱ 0.42 in 2005 owing to lower refinery expenses and higher crude run (2006: 141 mbd vs. 2005: 129 mbd).

Selling & Administrative Expenses of **₱ 4.5 billion** was maintained at last year's level. While the company provided for expenses related to the Guimaras oil spill clean-up operations, which have not yet been reimbursed by IOPC as of balance sheet date, these were offset by lower advertising expenses and reduced LPG cylinder purchases. There was also a downward adjustment in the allowance for doubtful accounts as receivables turnover rate improved from an average of 17x in 2005 to 18x during the first three quarters and 19x towards the last quarter of 2006.

Opex per liter sold was at **₱ 0.54**, slightly better than the previous year's ₱ 0.55 due mainly to incremental sales volume.

Net Financing Costs & Other Charges stood at **₱ 1.8 billion**, 13% higher (₱ 0.2 billion) than ₱ 1.6 billion posted a year earlier. The incremental cost was driven primarily by the hike in interest expense resulting from increased short-term borrowing level (2006 average: ₱ 23.9 billion vs. 2005 average: ₱ 15.8 billion) due to the spike in crude oil price.

Basic Earnings per Share was at last year's level of **₱ 0.64**.

<u>2005 vs. 2004</u>

The Company's net income climbed to ₱ 6.05 billion in 2005, recording a growth of 48% from the restated net earnings of ₱ 4.10 billion the year before.

Sales Volume for the year of 51.7 MMB showed a 1.1 MMB (2%) drop from last year's 52.8 MMB level. Domestic sales and supply sales went down by 3.2 MMB (7%) and 0.4 MMB (18%), respectively but significantly offset by the 2.5 MMB incremental volume contributed by the export market.

Sales increased by 30% (₱ 44.06 billion) to ₱ 191.49 billion from the ₱ 147.43 billion revenues in 2004. This was mainly due to the hike in MOPS prices as well as the upward adjustment in WPP to mitigate the effect of the escalation in crude prices.

Cost of goods sold went up to ₱ 177.21 billion, 31% or ₱ 41.81 billion higher than the ₱ 135.40 billion reported last year, prompted by the 40% or $13.99 escalation in FOB per barrel of crude that went into cost. The ₱ 0.97 average appreciation of the peso against dollar partly cushioned the effect of the recorded increase.

Gross margin per liter increased to ₱ 1.74 from ₱ 1.43 last year. However, gross margin rate was lower at 7.46% than the previous year's 8.16% level. This was traceable to lower margins from WPP-based sales. While the average duty-paid landed cost (DPLC) that was consumed during the year escalated by 37%, Wholesale Posted Prices (WPP) increased by only 33%. On the other hand, MOPS-based prices (Domestic & Exports) rose by 35%.

Refinery operating expenses (which form part of cost of sales) stood at ₱ 3.5 billion, exceeding the ₱ 2.9 billion recorded during the same period last year by ₱ 0.6 billion. The increase from last year's level was largely driven by the provision for obsolescence made for the refinery's storehouse items as well as depreciation expenses related to the ISOM and GOHT units, both of which were commercially operational on the first half of 2005.

Selling and administrative expenses went down to ₱ 4.5 billion from prior year's level of ₱ 4.9 billion. This was mainly a result of the early adoption of the amendments to PAS 19 (Employee Benefits), specifically allowing the recognition of actuarial gains and losses outside of profit and loss statement and instead present a statement of recognized income and expenses under equity.

Net financing costs and other charges amounted to ₱ 1.6 billion, lower than last year's ₱ 1.73 billion despite the escalation in crude and imported fuel prices owing to the rigid monitoring and application of the economics between a peso and dollar loan.

Provision for income tax of ₱ 2.09 billion was 58% (₱ 0.77 billion) more than the ₱ 1.32 billion a year ago on account of higher taxable income as well as the increase in corporate income tax rate from 32% to 35% effective November 1, 2005.

Basic earnings per share stood at ₱ 0.64, surpassing last year's ₱ 0.44 level by 45%.

2004 vs. 2003

Petron's restated **net income** of ₱ 4.10 billion for the year posted a 32% or ₱ 0.99 billion increase over the ₱ 3.11 billion earnings recorded during the same period last year. This was traceable mainly to higher gross margin, specifically from exports, substantially reduced by the escalation in operating charges.

Overall sales volume of 52.8 MMB was up by 6% or 2.9 MMB from the year ago level of 49.8 MMB. The incremental volume was contributed by domestic (by 5.6 MMB) and supply sales (by 0.4 MMB), partly reduced by the decline in export sales (by 3.0 MMB). The improvement in domestic market was attributable to the growth in Industrial Civil Trade (by 3.4 MMB) boosted by the climb in retail (by 1.1 MMB) and NPC sales (by 1.1 MMB).

Net revenues reached ₱ 147.43 billion, surpassing the previous year's level by 33% due essentially to higher MOPS-based prices, which rose by an average of 29% complemented by the 26% average increase in domestic Wholesale Posted Price (WPP) as well as the 6% growth in sales volume.

Cost of goods sold surged to ₱ 135.40 billion from the previous year's ₱ 101.35 billion traceable primarily to the combined effects of the $7.88/bbl escalation in FOB of crude that went into production, the $0.74/BBL hike in freight cost and the ₱ 1.83 average deterioration of the peso against the US dollar.

Gross margin of ₱ 12.03 billion showed an improvement of 28% (₱ 2.64 billion) from the ₱ 9.38 billion level last year. However, gross margin rate was lower at 8.2% from the previous year's 8.5% even with the ₱ 3.58 per liter average hike in selling price as the average duty-paid landed cost of crude processed during the period escalated by ₱ 3.46 per liter.

Selling and administrative expenses stood at ₱ 4.88 billion, 27% (₱ 1.04 billion) higher than the recorded operating expenses in 2003 of ₱ 3.84 billion driven by the following:

- Materials and Supplies rose by ₱ 214 million as the company bought more cylinder at higher prices this year. Also, write-on of cylinder deposits was higher in 2003 compared to 2004 (₱ 69 million – 2004 vs. ₱ 224 million - 2003).

- Advertising expenses increased by ₱ 176 million as a result of more aggressive marketing and promotional activities.

- Recognized ₱ 154 million in REAP related expense as mandated under IAS 19 which provides for the accrual of the benefit earned by the employee in the period it is earned rather than when paid or payable.

- Set up of allowance for uncollectible trade and non-trade accounts amounting to ₱ 162 million.

Financing and other charges increased to ₱ 1.73 billion from last year's level of ₱ 1.43 billion basically due to higher hedging cost and forex losses attributed to the escalation in crude and imported fuel prices as well as the ₱ 1.83 average deterioration of the peso against the dollar.

Financial Condition

2006

Petron's consolidated resources as of December 31, 2006 reached ₱ 87.5 billion, 27% or ₱ 18.6 billion higher than end-December 2005 level of ₱ 68.9 billion. The company's debt ratio slid to 0.63 from 0.60 of last year on account of newly availed long-term loans. On the other hand, current ratio improved to 1.5 from the 1.3 of end-December 2005.

Cash and cash equivalents of ₱ 11.7 billion was almost thrice the ₱ 3.9 billion level in end-December 2005. The healthy cash level was essentially driven by more efficient and effective working capital management implemented by the company which resulted in a 12% improvement in cash cycle as turnover rates for both receivables and inventory were faster, especially towards the last quarter of 2006. This was supplemented by long-term loan availment to finance the company's various refinery projects.

Financial assets at fair value through profit and loss went up to ₱ 180.0 million. The ₱ 64.0 million (55%) increase stemmed from the appreciation of the value of investments in marketable equity securities and proprietary membership.

Available-for-sale investments (current and noncurrent) increased to ₱ 632 million from last year's balance of ₱ 586 million on account of higher interest rate on government securities.

Receivables-net surged to ₱ 15.6 billion essentially on account of the ₱ 3.3 billion VAT claims from the government.

Other current assets went up by ₱ 5.8 billion influenced mainly by the input VAT on zero-rated sales.

Property, plant and equipment is higher by ₱ 2.6 billion (11%) due primarily to the capital expenditures related to the Refinery's PetroFCC project.

Depreciation reduced the value of **Investment Properties** to ₱ 222 million from ₱ 235 million in end-2005.

Other noncurrent assets declined by ₱ 639.0 million (51%) attributed primarily to the adjustment in pension asset as a result of the drop in discount rate used in determining obligations for the company's pension plan.

Short-term loans increased by ₱ 6.7 billion (31%) emanating from higher crude oil and finished product importation costs.

Supplier's credits dropped to ₱ 7.5 billion from ₱ 7.9 billion as crude prices fell towards the end of 2006.

Accounts payable and accrued expenses settled at ₱ 3.7 billion, ₱ 1.1 billion higher than the December 31, 2005 balance of ₱ 2.6 billion emanating mostly from accrual of interest and other operating expenses as well as liabilities to contractors and suppliers.

Income tax payable rose to ₱ 452 million as a result of the increase in tax rate from 32.5% to 35%. Additionally, the income tax holiday on Mixed Xylene ended on December 5, 2006.

Long-term debt-inclusive of current portion rose by almost ₱ 6.0 billion. The increase stemmed from the issuance of the ₱ 6.3 billion 5-year fixed rate corporate note (FXCN) and the ₱ 2.0 billion long term loan from Land Bank partly reduced by payments made on matured loans.

Deferred income tax liabilities dropped by ₱ 73.0 million as a result of the adjustment to consider the change in tax rate to 30% in 2009.

Other non-current liabilities surged to ₱ 1.05 billion as Asset Retirement Obligation (ARO) was more than twice the December 2005 level.

Retained earnings-appropriated increased to ₱ 17.0 billion following the approval of the Board to set aside ₱ 5.4 billion of the unrestricted earnings for future capital investments.

Other reserves resulted in a negative balance of ₱ 490 million influenced mainly by the recognition of actuarial losses on the company's pension fund.

2005

The restated total resources as of December 31, 2005 reached ₱ 68.89 billion, 11% or ₱ 7.24 billion higher than end-December 2004 level of ₱ 61.65 billion. The company's debt ratio improved to 0.60 as of December 31, 2005 on account of higher earnings. Current ratio stood at 1.3, better than 1.2 last year.

Financial assets through profit or loss of ₱ 116 million pertain to marketable equity securities and proprietary membership shares which are presented separately as required under PAS 32 (Financial Instruments: Disclosure and Presentation).

Available-for-sale investments (current and noncurrent) of ₱ 586 million consisted of investments in government securities of Petrogen which are deposited with the Insurance Commission in accordance with the provisions of the Insurance Code, for the benefit and security of policyholders and creditors of Petrogen.

Receivables-net went up by ₱ 1.6 billion (15%) on account primarily of higher sales posted for exports and industrial accounts.

Inventory increased by ₱ 4.60 billion traceable to:

- Escalation in finished product cost (12/05 - ₱ 23.25 P/li. vs. 12/04 - ₱ 19.18 P/li.) equivalent to ₱ 2.67 billion.

- Increase in crude cost (12/05 - ₱ 19.85 P/li. vs. 12/04-₱ 15.08 P/li.) resulting in a ₱ 2.89 billion increment.

- Tempered by the drop in inventory level of both finished products (0.17 MMB) and crude (0.03 MMB) translating to ₱ 0.71 billion

Other current assets increased by ₱ 0.51 billion (64%) influenced essentially by the transitional input VAT resulting from the imposition of VAT on crude and finished products under the new E-VAT law which was implemented starting November 1, 2005.

Investment Properties of ₱ 0.23 billion pertained to portions of the building being leased to third parties, a rest house unit for executive use, and parcels of land of NVRC intended for service stations which were reclassified from property, plant and equipment in compliance with PAS 40 (Investment Property

Other noncurrent assets went down by ₱ 0.09 billion (7%) on account primarily of the reclassification of investment in shares of stock and notes/bonds to fair value through profit or loss (FVPL) and available-for-sale (AFS), respectively.

Supplier's credits and **short-term loans** increased by ₱ 4.71 billion (19%) triggered by escalating prices of crude and finished products.

Accounts payable and accrued expenses decreased by ₱ 980 million (27%) due mainly to retention fees paid to contractors for completed projects/contracts.

Long-term debt went down to ₱ 5.03 billion from year-end 2004 balance of ₱ 7.23 billion as the portion of long-term loans obtained from Citibank, Landbank and NORD that will mature in a year's time was taken up under current liabilities. There was also no long-term loan availment in 2005.

Retained earnings-appropriated increased to ₱ 11.65 billion from the December 2004 level of ₱ 6.91 billion on account of the provisions made for the 2006 capital program. As a result, the increase in **retained earnings-unappropriated** was trimmed down to ₱ 0.73 billion.

Other reserves of ₱ 128 million was traceable largely to net actuarial gain recognized directly to equity.

2004

Total resources as of December 31, 2004, aggregated ₱ 61.65 billion, 23% or ₱ 11.55 billion higher than the ₱ 50.10 billion posted in 2003. While Petron's debt ratio rose from 0.62 as of December 31, 2003 to 0.64 as a result of the increases in both short and long-term loans used to finance importations and capital projects, current ratio improved to 1.2 from 1.1 in 2003.

Cash and cash equivalents increased by ₱ 776 million or 24.27% emanating primarily from month-end collections from customers.

The upward oil price adjustments coupled with higher sales volume accounted primarily for the ₱ 1.90 billion or 22.51% upturn in **receivables-net**.

The build-up in **inventories** by ₱ 6.74 billion or 43% was attributable essentially to the retroactive effect of the adoption of PAS 2 (Inventories) which prohibits the LIFO method of costing petroleum products. Higher crude and finished product prices also contributed to the increment.

The additional allowance provided by the company for the decline in value of investment for All Asia accounted mainly for the ₱ 59 million decrease in **Investments-net.**

Property, plant and equipment grew by ₱ 0.95 billion or 4% on account largely of the capital expenditures for Gasoil Hydrotreater Plant and Isomerization Unit. This is net of the ₱ 2.2 billion deduction in PPE brought about by the retroactive effect of the adoption of PAS 21 (Effects of Changes in Foreign Exchange Rates) which prohibits the capitalization of foreign exchange losses.

Other non current assets climbed to ₱ 1.27 billion from ₱ 80 million in December 2003 brought about principally by the recognition of transitional pension asset which resulted from the retroactive application of PAS 19 (Employee Benefits).

Short-term loans increased by ₱ 3.09 billion or 20% due mainly to peso and dollar loans obtained from banks to finance importation of crude and petroleum products.

Liabilities for crude oil and petroleum product importation decreased by ₱ 432 million due to lower crude purchases in December 2004 (by 261 MB).

Accounts payable and accrued expenses increased by ₱ 742 million or 26% on account largely of retention payable related to the on-going construction of major capital projects in the refinery as well as liabilities to local suppliers and contractors.

Income tax payable rose to ₱ 278 million since prior years' NOLCO and MCIT were already fully applied in 2003.

The **current portion of long-term debt** totaling ₱ 1.60 billion was more than twice the end-December 2003 level of ₱ 712 million on account of long-term loans obtained from Landbank and Citibank which will be due for payment in a year's time.

Non-current liabilities and deferred credits rose by ₱ 4.35 billion or 89% on account principally of the outstanding dollar denominated loan ($100 million) obtained from NORD for major capital projects.

Increase in **retained earnings-unappropriated** by ₱ 960 million pertained essentially to the ₱ 4.10 billion earnings for the period ended December 2004 less dividends declared of ₱ 1.88 billion and appropriation for future capital projects of ₱ 1.36 billion. Retroactive application of the new Philippine Accounting Standards (PAS) also contributed to the increment.

Cash Flows

2006 vs 2005

Cash flows generated from operating activities for the 12-month period of ₱ 4.4 billion was more than twice the ₱ 2.0 billion level the year before owing largely to better working capital management.

2005 vs 2004

Petron registered an operating cash inflow of ₱ 2.0 billion, significantly higher than the YTD December 2004 level of ₱ 191 million owing mainly to better earnings this year.

2004 vs 2003

Cash flows from operating activities dropped to ₱ 191 million this year from ₱ 2.91 billion last year driven principally by the build-up in operating assets.

Financial Condition

Item 7. Financial Statements	**2006**	**2005**	**(As Restated) 2004**
b) Cash and Cash Equivalents			
Cash in bank (Peso)	3,032	2,821	2,348
Cash in bank ($)	735	755	1,082
Marketable securities ($)	7,968	495	674
Total	**11,735**	**3,940**	**4,104**

c) Accounts Receivables-Others			
Borrow and loan	82	129	93
Unapplied withholding taxes/ tax certificates		-	30
Others	4,743	691	748
Total	**4,825**	**820**	**871**

d) Selling and Administrative Expenses			
Depreciation and amortization	946	876	847
Employee costs	1,199	1,023	1,225
Purchased services and utilities	817	748	734
Maintenance and repairs	473	567	629
Advertising	222	398	403
Rent expense	381	306	271
Materials and office supplies	164	281	260
Expenses Related to oil spill incident in Guimaras	122	-	-
Taxes and licenses	104	102	177
Provision for doubtful accounts	3	106	162
Others	54	120	169
Total	**4,485**	**4,527**	**4,877**
e) Other Income, Interest Expense and Others			
Interest income	362	317	344
Interest expense	(2,684)	(2,091)	(1,675)
Rent income	345	280	274
Derivatives net mark to market (MTM) gain (loss)	(279)	(260)	-
Foreign exchange gain (loss)	388	306	(298)
Reversal of allowance of doubtful accounts	166	-	-
Changes in fair value of financial assets at FVPL	63	14	(91)
Insurance claims	29	-	-
Gain on ARO settlement	13	-	-
Miscellaneous	(226)	(176)	(280)
Total	**(1,823)**	**(1,610)**	**(1,726)**

Top Five (5) Key Performance Indicators

Ratio	Dec-06	(As Restated) Dec-05
Current Ratio	1.5	1.3
Debt Equity Ratio	1.7	1.5
Return on Equity (%)	20.1	24.2
Debt Service Coverage		
Citibank	3.3	1.9
NORD/BPI	3.2	1.8
Tangible Net worth	₱ 32.3B	₱ 27.6B

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 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.

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 balance sheet. 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.

Debt Service Coverage - Free cash flows add available closing cash balance divided by projected debt service.

This ratio shows the cash flow available to pay for debt to the total amount of debt payments to be made. It also measures the company's ability to settle dividends, interests and other financing charges.

Tangible Net Worth - Net worth minus intangible assets.
This figure gives a more immediately realizable value of the company.

Exchange Rate Volatility

The peso rallied against the dollar as it strengthened to ₱51.3 in 2006 from ₱55.1 in the previous year. Surging OFW remittances, coupled with favorable export growth and heavy investment flows due to generally improved sentiment on the economy, all drove the peso to its highest level in four years. The strong currency has been favorable in terms of lower importation and debt service costs for most capital-intensive or highly leveraged firms.

Known Trends

Higher crude prices prevailed in 2006

Dubai crude oil price averaged $61.5 per barrel in 2006, 24% higher than the previous year average of $49.5. Prices were supported by relatively strong demand amidst marginal supply increases, geopolitical factors, and tightening refining capacity. Increased speculative activity likewise raised the premium on oil prices.

During the year, prices peaked at $69 in July and softened to about $59 towards the end of 2006 due to boost in non-OPEC supply coupled with mild weather conditions in the US, Japan and Europe. These countered geopolitical concerns in Iran and Nigeria.

Inflation and Interest Rates

Inflation rate fell to 6.3% in 2006 from 7.6% in 2005 mainly due to the recovery of the agricultural sector which kept food supply relatively stable, and strengthening of the peso versus the dollar which helped keep down local prices of imported commodities. Softening of world oil prices towards the end of 2006 likewise contributed to lower inflation.

Reflective of bullish market sentiment and positive outlook on the government's fiscal position, 91-day T-bill rate average slid to 5.4% for the whole year from 6.4% in the previous year. Excess market liquidity, reduced government borrowings in light of relatively improved fiscal position, modest inflation and implementation of the tiering scheme on bank's placements with the central bank eased interest rates.

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

TCC Related Cases

In 1998, the Company contested before the Court of Tax Appeals (CTA) the collection by the Bureau of Internal Revenue (BIR) of deficiency excise taxes amounting to ₱1.11 billion representing back taxes, surcharge and interest arising from the Company's acceptance and use of Tax Credit Certificates (TCCs) worth ₱659 million from 1993 to 1997. In July 1999, the CTA ruled that, as a fuel supplier of BOI-registered companies, the Company was a qualified transferee for the TCCs. The CTA ruled that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. The BIR appealed the ruling to the Court of Appeals where the case is still pending.

In November 1999, the Department of Finance (DOF) Center ExCom cancelled Tax Debit Memos (TDMs) worth ₱475 million, the related TCCs and their assignments. The BIR implemented this with a letter of assessment worth ₱651 million deficiency taxes (inclusive of interest and charges) for the years 1995 to 1997, as a result of the cancellation. The Company contested on the grounds that the assessment has no factual and legal basis and that the cancellation of the TDMs was void. The Company elevated this protest to the CTA on July 10, 2000. On August 23, 2006, the Second Division of the CTA rendered its Decision denying Petron's petition and ordered it to pay the BIR ₱580 million representing deficiency excise taxes for 1995 to 1997 plus 20% interest per annum from December 4, 1999. Petron's motion for reconsideration was denied on November 23, 2006. Petron has filed the necessary appeal with the CTA en banc and awaiting resolution thereon.

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

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

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

Petron officers who were already arraigned in the first Sandiganbayan case went up to the SC after the Sandiganbayan reversed an earlier ruling dismissing the case for failure on the part of the Ombudsman to prosecute. The second Sandiganbayan case remains pending.

Pandacan Terminal Operations

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

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

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

To date, the first phase of the engineering, procurement and construction is already more than 98% complete. On the other hand, the second phase of the engineering, procurement and construction is 40% complete.

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

Simultaneous with the Scale Down Program, the case of Social Justice Society vs. Atienza (SJS vs. Atienza case) was filed on December 31, 2002. In April 2003, subsequent to the filing of the SJS vs. Atienza case, Petron, Shell and Chevron filed separate cases before the RTC questioning the constitutionality and validity of Ordinance No. 8027. Shell and Chevron were able to secure TRO and, after further proceedings, writs of preliminary injunction against the City of Manila and/or its officials from implementing Ordinance No. 8027. The separate cases of Shell and Chevron remain pending to date and the writ of injunction continue in effect. On the other hand, Petron was able to secure a status quo Order from the RTC, following an agreement between Petron and the City of Manila to maintain the status quo Order until further orders of the Court or termination of the case. The case was referred to mediation before the Philippine Mediation Center but the parties failed to come to any agreement.

During the pendency of the above-cited cases, on March 16, 2006, the City Council passed City Ordinance No. 8119 (Ordinance No. 8119) adopting the Comprehensive Land Use Plan and Zoning Regulations of 2006 in which, the area of the oil terminals was reclassified as high density residential/mixed zone use, and at the same time gave non-conforming establishments seven years from effectivity of the Ordinance No. 8119 to relocate. Shell and Chevron filed a Complaint against the City of Manila questioning the validity and constitutionality of Ordinance No. 8119 and said case is currently being heard for presentation of evidence by Shell and Chevron. Petron has filed its own Complaint questioning Ordinance No. 8119 before the RTC and Petron has been able to secure a TRO preventing the City of Manila from enforcing the Ordinance No. 8119.

As a result of the passage of Ordinance No. 8119, on February 20, 2007, Petron, Mayor of Manila and the City Council filed a Joint Motion to Withdraw Complaint and Counterclaims in the case filed by Petron questioning Ordinance No. 8027, citing that Ordinance No. 8119 repealed Ordinance No. 8027, for which reason, the case filed by Petron before the RTC has been rendered moot.

On March 7, 2007, the Supreme Court rendered a Decision in the case of SJS Society vs. Atienza, directing the Mayor of Manila to immediately enforce Ordinance No. 8027. It is Petron's position that the Supreme Court failed to consider supervising events, notably (i) the passage of Ordinance No. 8119 which supersedes Ordinance No. 8027, as well as (ii) the writs of injunction from the RTC presenting the implementation of Ordinance No. 8027. On March 12, 2007, Petron, together with Shell and Chevron, filed an Urgent Motion for Leave Intervention and Urgent Motion to Admit Motion for Reconsideration of the decision dated March 7, 2007, citing the foregoing grounds that make SC's decision and the enforcement of Ordinance No. 8027 improper. Further, Petron, Shell, and Chevron noted the ill-effects of the sudden closure of the Pandacan Terminals on the entire country.

On March 22, 2007, the Department of Energy, through its counsel, the Office of the Solicitor General, filed a motion for the government to intervene, in support of the oil companies' position. On March 23, 2007, Petron received an order from the Supreme Court ordering the parties to file their comments within 5 days from receipt of the order and setting the same for oral arguments. This order in effect, stayed any action by the City of Manila.

The company is in the process of finalizing the study of various alternatives. As of April 3, 2007, an estimate of the potential impact cannot be made yet.

Navotas Business Tax

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

Oil Spill Incident in Guimaras

M/T Solar I sank in rough seas in the afternoon of August 11, 2006 en route to Zamboanga, loaded with about 2 million liters of industrial fuel oil. It now lies about 640 meters beneath the sea, at approximately 13 nautical miles southwest of Guimaras.

Petron immediately dispatched its oil spill gear, equipment and oil spill teams upon receiving information of the incident. An aerial and surface assessment was conducted to determine the extent of the spill.

Inspection by the Survey Ship Shinsei Maru, using a remote-operated vehicle (ROV), found the vessel upright and in stable condition with minimal traces of leakage. All cargo compartment valves were tightened by the ROV to ensure against further leakage. The Shinsei Maru was contracted by the P&I Club and the International Oil Pollution Compensation (IOPC) from Fukada Salvage & Marine Works Co. Ltd.

On separate investigations conducted by the Special Task Force on Guimaras by the Department of Justice and the Special Board of Marine Inquiry (SBMI), both found the owners of M/T Solar I (Sunshine Marine Development Corporation) liable. The DOJ found no criminal liability on the part of Petron. However, the SBMI found Petron to have overloaded the vessel. Petron has appealed the findings of the SBMI to the Department of Transportation and Communication (DOTC) and is awaiting its resolution.

On September 18, 2006, the Mayor of Nueva Valencia, Guimaras filed a criminal complaint before the Fiscal's Office in Guimaras against Petron officers and the President of Sunshine Maritime Development Corporation for violation of environmental laws. A resolution was issued by the public prosecutor dismissing the criminal complaint on all counts. A Motion for Reconsideration was filed by the counsel for Guimaras Municipality last April 4, 2007; on the other hand, counsel for Petron filed opposition to the Motion for Reconsideration. The Company is awaiting resolution on this incident.

The Company implemented a "Cash for Work" program involving residents of the affected areas in the clean-up operations, providing them with a daily allowance. The Company also mobilized its employees to assist in the operations. By the middle of November 2006, Petron had cleaned up all affected shorelines and was affirmed by the inspections made by Taskforce Solar 1 Oil Spill (SOS), a multi-agency group composed of officials from the Local Government Units, Departments of Health, Environment and Natural Resources, Social Welfare and Development, and the Philippine Coast Guard.

The Company collected a total 6,000 metric tons of debris which were brought to the Holcim Cement facility in Lugait, Misamis Occidental for processing/treatment of waste. On November 20, 2006, one of the last barge shipments of oil debris unfortunately sunk en route to the same plant[1].

The Company is working closely with the provincial government, Department of Welfare and Social Development (DSWD), Department of Agriculture (DA), Technical Education and Skills Development Authority (TESDA), the Philippine Business for Social Progress (PBSP), in developing livelihood programs for the locals. Last November 27, 2006, Petron held a scientific conference in cooperation with the University of the Philippines - Visayas, the National Disaster Coordinating Council (NDCC), the World Wildlife Fund (WWF) and the Guimaras Provincial Government with the objective of developing an integrated assessment and protocol for the rehabilitation of the province. The Company has also replicated its own educational programs in partnership with the Department of Education. Ground breaking ceremonies for the construction of a four-classroom school in Barangay Tando, Nueva Valencia and a Library Hub in Barangay San Miguel, Jordan Guimaras was held last March 15, 2007. The two facilities are expected to be open in time for the next school year.

With regard to the retrieval of the remaining oil still trapped in M/T Solar I, the P & I contracted a sub-sea systems technology provider (Sonsub) to recover the oil from the sunken vessel. The recovery vessel AME Allied Shield arrived at BREDCO Pier in Bacolod City last March 10. After unloading the ISO-

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1 To dispel fear of contamination in the area, personnel and equipment were brought to the sink site. In separate statements made by the Philippine Coast Guard (PCG), DENR and the Bureau of Fisheries and Aquatic Resources (BFAR), they found no traces of oil in the water. Petron engaged the services of Mindanao State University and Dr. Angel Alcala of the Silliman University to conduct an impact assessment of the sunken debris on the environment. Both studies concluded that the sinking of the ship had no effect on the environment.

certified tanks and hoses, the vessel proceeded to site on March 11, 2007. Oil recovery operation was technically completed on April 1, 2007. A total of 9,000 liters of oil was recovered.

Representatives from the IOPC met with the claimants from various affected areas of Guimaras to give an orientation on the requirements of the claim as well as the documents required to be submitted in support of the claim. Petron has filed a total of ₱188 million against the IOPC. As of January 2007, a total of ₱105 million has been paid to Petron Payment of claims for Guimaras fishermen were completed in March 2007. Release of checks for Iloilo claimants will start on the second week of April 2007.

Total expenses incurred as of December 31, 2006 amounted to ₱122 (net of reimbursements from IOPC amounting to ₱105) (see Note 18).

All material off-balance sheet transactions, arrangements, obligations (including contingent obligations), and other relationships of the company with unconsolidated entities or other persons created during the reporting period.

There are no off-balance sheet transactions, arrangements and obligations with unconsolidated entities or persons during the reporting period.

Audit and Audit-Related Fees

For the annual review of the financial statements and other assurance related services, the audit fees in 2005 and 2006 were P2.8 million and P2.9 million, respectively excluding VAT and out of pocket expenses which is 10% of the contract prices.

Petron's external auditor is selected through sealed bidding wherein qualified auditing firms are invited to participate. For the audit of annual financial statements, award is endorsed by the Board Audit Committee and approved by the company's shareholders during its annual meeting. Award of other related audit services is approved by the Audit Committee as endorsed by the company's Internal Audit Department.

The Audit Committee assists the Board of Directors in its oversight function with respect to the adequacy and effectiveness of internal control environment, compliance with corporate policies and regulations, integrity of the financial statements, the independence and overall direction of the internal audit function, and the selection and performance of the external auditor.

In 2006, the Committee reported that:

- It reviewed and discussed with Controllers management the quarterly and annual financial statements of Petron Corporation and Subsidiaries and endorsed these for approval by the Board.

- The independent auditors, SGV and Co., presented to and discussed with the Committee the scope and timing of their annual audit plan and focus areas related to their review of the financial statements.

- SGV and Co. briefed the members of the Audit Committee on the new accounting standards that were adopted by Petron in 2005 and their impact on the financial statements. Similarly, new accounting standards for adoption in 2006 and their possible effect on the financial statements were also presented.

- It reviewed with SGV and Co. the external auditors' audit observations and recommendations on the company's internal controls and management's response to the issues raised.

- It reviewed with the Internal Audit Manager and approved the annual internal audit plan and satisfied itself to the independence of the internal audit function.

- It reviewed on a quarterly basis Internal Audit's report on the adequacy and effectiveness of the internal control environment in the areas covered during the period.

- Based on a review of the external auditors' performance, it recommended to the Board and the Shareholders the reappointment of SGV and Co. as Petron's independent auditor for 2006.

- It reviewed and approved the engagement of services and related fees of other audit service providers.

All the four members of the Audit Committee, two of whom are independent directors, were satisfied with the scope and appropriateness of the Committee's mandate and that the Committee substantially met its mandate in 2006.

Material Commitments for Capital Expenditure

The Company's proposed capital program for 2007 amounts to ₱5.0 billion, ₱4.4 billion for major capital projects, and ₱583 million for miscellaneous projects.

Major capital projects include:

1. Refinery Expansion Project. On the back of the success of the Mixed Xylene project, the Company will expand further into the petrochemicals business. Total investment is estimated at ₱3.2 billion.
2. Reseller Funds Pool. The ₱319 million project is geared towards protecting market share in the retail market.
3. JOCASP Tank Farm Relocation. The development plans of the government for NAIA requires the relocation of the JOCASP tank farm estimated at ₱260.0 million.
4. Ethanol Program. In order to comply with the new law, installation of facilities to enable the blending of ethanol into gasoline is necessary by 2007. Estimated project cost for installation of facilities amounts to ₱205.0 million.

(B) Changes in and Disagreements With Accountants on Accounting and Financial Disclosure

There are no changes in and disagreements with Accountants on Accounting and Financial Disclosure.

PART IV – MANAGEMENT AND CERTAIN SECURITY HOLDERS

(A) Directors and Executive Officers of the Registrant

Described below are the business experiences of the company's Directors and Executive Officers for the past five (5) years.

(1) Directors

Nicasio I. Alcantara, Filipino, 64 years old, has been an Executive Director and the Chairman of Petron Corporation since July 30, 2001. At present, he is also the Chief Executive Officer. Currently, he is also Chairman (without voting rights) of the Board Compensation Committee and a member of the Board Nomination Committee. Before his election to the Board of Petron Corporation, he was Chairman and/or President of various corporations of the Alcantara Group of Companies, such as Alsons Power Holdings, Inc., Alson Power Holdings Corp., Southern Philippines Power Corp., Western Mindanao Power Corp., Northern Mindanao Power Corp., Alto Power Corporation, MADE (Market Developers), Inc. and Conal Holdings Corporation. He was a Director of United Pulp and Paper Co. from May 1986 to 2003. Mr. Alcantara is currently a Director of Alsons Corporation, Conal Corporation, Alsons Insurance Brokers Corp., Sarangani Agricultural Co., Inc., Alsons Aquaculture Co., Inc., Aquasur Resources Corporation, Finfish Hatcheries, Inc., Buayan Cattle Co. Inc., Alsons Development & Investment Corp., Alsons Land Corporation, Lima Land, Inc., C. Alcantara & Sons, Inc., Refractories Corp. of the Philippines, Bancasia Capital Corporation, Bank One Savings & Trust Corporation, The Philodril Corporation and T'boli Agro Industrial Corporation. He also serves as a member of the Boards of Trustees of the Philippine Institute of Petroleum (PIP), the Philippine Business for Social Progress (PBSP) and the Junior Achievement of the Philippines (JAPI). He earned his Business Administration degree from the Ateneo de Manila University and his Masters degree in Business Administration from Sta. Clara University, California.

Khalid D. Al-Faddagh, Saudi Arabian, 51 years old, has been a Director since July 2001 and was elected President and thus, an Executive Director of the Company since July 29, 2003. He was the Chief Executive Officer from July 2004-2006. Currently, he is a member (without voting rights) of the Board Compensation Committee and the Board Nomination Committee Mr. Al-Faddagh has more than 20 years experience in the oil industry and held various professional and management positions in Saudi Aramco from January 2001 to July 2003. Mr. Al-Faddagh was also the Manager for the Abqaiq Plants Maintenance Department of Saudi Aramco from July 1983 to January 2001. He has a Doctorate Degree in Mechanical Engineering from the Imperial College, London University and attended several executive programs including a recent one at Harvard Business School.

Ahmad O. Al-Khowaiter, Saudi Arabian, 40 years old, was elected as Director on July 25, 2005 and is a member of the Board Compensation Committee. He is currently the Manager of Facility Planning of Saudi Aramco. Mr. Al-Khowaiter has been a Superintendent in Haradh Gas Plant from 2002 to 2003 and in Hawiyah Gas Plant Engineering Division from 2000 to 2002. He has been a Senior Project Engineer in Exploration Application Services Department from 1997 to 2000. He has a Bachelor of Science degree in Chemical Engineering from King Fahad University of Petroleum & Minerals in Dhahran, Saudi Arabia. He received his M.S. in Chemical Engineering from the University of California and is presently taking an MBA course from the Massachusetts Institute of Technology (MIT) Sloan School of Management.

Basil A. Abul-Hamayel, Saudi Arabian, 43 years old, has been a Director of the Company since July 2004 and currently a member of the Board Audit Committee. Mr. Abul-Hamayel has 24 years of service with Saudi Aramco and has occupied several professional and managerial positions. Currently, he is the manager of Corporate Finance, Insurance and Asset Management Department of Saudi Aramco. Prior to this position, Mr. Abul-Hamayel was Petron's Vice President of Corporate Planning. He was also a Director of Petron Foundation, Inc., Petron Marketing Corporation and Petron Freeport Corporation until September 2005. Prior to Petron, he was the leader of the finance team involved in negotiating, on behalf of the Government of Saudi Arabia, the upstream gas exploration concessions with the International Oil Companies (IOCs) which function he held from September 2001 to October 2003. Prior to this assignment, he was seconded to the World Bank Group in Washington D.C., from 1999 to 2001, where he was a Senior Financial Specialist in the Oil, Gas and Chemicals division. He holds an undergraduate degree in economics from the University of Texas at Austin (1987) and an MBA in Finance from the Massachusetts Institute of Technology (MIT) Sloan School of Management (1996).

Herminio S. Aquino, Filipino, 57 years old, has been a Director of the Company since November 2004 and currently a member of the Board Audit Committee. He is also the Chairman of Trackworks, Inc., Interconsult (Asia Pacific), Inc. and 7-Series, Inc. He was the Vice Governor of the Province of Tarlac from 1998 to 2001 and was Congressman for the 3rd District of Tarlac for three terms from 1987 to 1998. While in Congress, he was Chairman of the Committee on Energy from 1987 to 1992 and Vice-Chairman from 1992 to 1998 and was a member of various other Committees. He also worked under the Executive Branch as Deputy Executive Secretary for Human Settlements and Chairman of various government agencies such as Ministry of Human Settlements, Housing and Urban Development Coordinating Council, Bagong Kilusang Kabuhayan at Kaunlaran and Human Settlements Development Corporation. Mr. Aquino holds a Bachelor of Arts degree, major in Economics from the Ateneo de Manila University and a Masters in Business Administration from the Asian Institute of Management.

Alberto A. Pedrosa, Filipino, 74 years old, was elected Director of the Company last March 2005. Presently, he sits as member of the Board Nomination Committee. He is currently the Chairman and Publisher of Republika, a newsmagazine focused on the 42,000 barangays in the country. He is also the Chairman of People's Initiative for Reform, Modernization and Action (PIRMA). He was a Member of the Board of Directors of Philippine Deposit Insurance Corporation and former Ambassador Extraordinary and Plenipotentiary to Belgium, Luxembourg and the European Union from 1992 to 1995. He also worked as Chairman of the Asean Brussels Committee from September 1993 - March 1994, adviser of Philippine Delegation on the 12th ASEAN-EC JCC, Brussels in October 1995, member of delegation, ASEAN-EU Ministerial Meeting in Karlaruhe, Germany in September 1994 and was Secretary of the Confederation of Philippine Embassies in Europe. He was former Chairman of the Confederation of Filipino Overseas Organizations, London. Mr. Pedrosa was also a trainee in the Foreign Department, Bankers Trust Company; in ocean traffic management and operations, and in sugar trading and brokering under different New York firms. Mr. Pedrosa holds a Bachelor of Arts degree, major in Economics from the University of the Philippines. He also took post-graduate studies at Sciences-Po in Public Economics at the University of Paris and summer seminar in Luxembourg on the European Economic Community, Faculte' d'Economie Comparee, Luxembourg.

Khalid G. Al-Buainain, Saudi Arabian, 48 years old, has been a non-executive Director of the Company since July 29, 2003. He is a member of the Board Compensation Committee and is currently the Vice President for Refining of Saudi Aramco since June 2003. Prior to his appointment, from June 2001 to May 2003, he served as Vice President of Medical Services. From May 1999 to May 2001, he was in charge of Saudi Aramco Affairs, first as Executive Director and later as Vice President. He is currently the Chairman of Luberef and a member of the Saudi Aramco Executive Advisory Committee. He has a Bachelor of Science degree in Mechanical Engineering from the University of Petroleum and Minerals and attended the Executive Program at the Harvard Business School in 1999.

Bernardino R. Abes, Filipino, 76 years old, has been a non-executive Director of the Company since July 2001 and is presently a member of the Board Compensation Committee. He is currently the Chairman of the Government Service Insurance System, following a three-year term as Chairman of the Social Security Commission. He was also a Director of Union Bank of the Philippines, First Philippine Holdings, Philex Mining Corporation, Belle Corporation and Clark Development Corporation. He held the position of Presidential Adviser on Legislative Affairs and Head, Presidential Legislative Liaison Office in 2001. Other positions include: Consultant for the Philippine Senate (1992 to 1993), Director for Bureau of Labor Relations (1957-1961), Secretary of Labor (1962-1964), Administrator and Chairman of SSS (1963-1965). He graduated from the University of Santo Tomas with a Bachelor of Laws degree.

Douhan H. Al-Douhan, Saudi Arabian, 71 years old, has been an Independent Director since July 2001. He is a member of the Audit Committee and of the Nomination Committee. He has been the Managing Director of Randa Trading & Construction in Saudi Arabia since 2004. He is also a Partner and member of the Board of Directors of Gabas Alkhaleej, also in Saudi Arabia since 2004. He was a retired Executive Director of Management Services Organization and former Assistant Secretary to the Board of Directors of Saudi Aramco until December 31, 1995. In Saudi Aramco, he held several management positions in the Loss Prevention Department, Oil Producing Operations and Maintenance Department and Government Affairs Organization. He was actively involved in several committees like the Corporate Executive Compensation Committee, Management Development and Organization Committee, Services Review Committee, Ethics and Conflict of Interest Committee, Donation Committee, Saudi Manpower Committee and Corporate Task Force for Manpower Review. Mr. Al-Douhan has a Bachelor of Science degree in Engineering Technology with emphasis in Manufacturing from the Memphis State University, Tennessee, U.S.A.

Emilia T. Boncodin, Filipino, 52 years old, is an Independent Director since April 2006. She is currently a Professor at the National College of Public Administration and Governance of the University of Philippines and is also connected with the Commission on Audit Professorial Award. She was the Secretary of the Department of Budget and Management from January 2001 to July 2005 and in February to June 1998. She served as Undersecretary and Chief of Staff of the said Department from May 1991 to February 1998. Ms. Boncodin worked as Chairperson of the Board/Commission/Committee of the Development Academy of the Philippines, Technology and Livelihood Resource Corporation, Pasig River Rehabilitation Commission, Development Budget Coordination Committee from January 2001 to July 2005 and of the Government Procurement Policy Board from February 2003 to July 2005. She was the Vice Chairperson of the Presidential Committee for Effective Governance from 2001 to 2004. From 2001 to 2005, she was as Member of the Legislative-Executive Development Advisory Council, Investment Coordination Committee, Privatization Council, National Anti-Poverty Commission, National Power Corporation, Power Sector Assets and Liabilities Management Corporation and Presidential Agrarian Reform Committee. In 1999 to 2001, she became the Executive Director of Ramos Peace and Development Foundation and was a Partner in Resource and Measures Associates. She was the Treasurer of the UP Provident Fund in 2000. Ms. Boncodin graduated from the University of the Philippines with a degree in Business Administration and Accountancy. She was an Edward S. Mason Fellow of the Kennedy School of Government, Harvard University where she earned her Masters degree in Public Administration.

(2) Other Executive Officers

Jose K. Campos, Jr., Filipino, 61 years old, has been the Vice President for Marketing since April 15, 2002 and was the Vice President for Supply and Operations from June 1, 2001 to April 14, 2002. He is concurrently Vice President and Chief Operating Officer of two subsidiaries, Petron Marketing Corporation and Petron Freeport Corporation. He is also a Director of Petron Marketing Corporation and Petron Freeport Corporation and a Trustee of Petron Foundation, Inc.. He started working for the Company (then known as Esso Philippines, Inc.) on October 20, 1969 as an analyst in the Marketing Economics and Research Department. He transferred to Industrial Trade in June 1972 as an Account Executive and became Government Sales Supervisor in April 1974. He was named Industrial Sales Manager for Visayas and Mindanao, based in Cebu, in May 1977, and returned to Manila as District Sales Manager for Metro Manila in October 1984. He became Reseller Sales Manager for Luzon in 1986 until he assumed stewardship of Industrial Trade in November 1991. He was Reseller Trade Manager from January 1995 until he was appointed Manager for Strategic Planning in January 1999. He has been with the Company for 37 years, and has attended various management courses both in the Philippines and abroad. He has a Bachelor of Science degree in Economics from the Ateneo de Manila University.

Antonio G. Pelayo, Filipino, 52 years old, has been the Vice President for Finance and Subsidiaries since May 7, 2002. He is also a Director and President/CEO of New Ventures Realty Corporation and Las Lucas Development Corporation, an NVRC subsidiary; Director and Vice President of Petrogen Insurance

Corporation; Director of Petron Marketing Corporation and Petron Freeport Corporation; Deputy Director of Overseas Ventures Insurance Corp. Ltd.; and Trustee of Petron Foundation, Inc. He was the Controller of the Company from May 8, 2001 to May 19, 2004. He has a Bachelor of Science in Commerce degree major in Accounting from the University of Santo Tomas and is a Certified Public Accountant. He earned his MBA units from the Ateneo de Manila University and B.S. Economics units from the De La Salle College – Bacolod. He completed executive and leadership programs from Cornell University, University of Virginia and the American Graduate School of International Management (Thunderbird), all in the U.S.A.

Felimon E. Antiporta, Filipino, 59 years old, is the Vice President for Supply and Operations. He is a Trustee of the Petron Foundation, Inc. and a Director of the Pandacan Depot Services, Inc., operator of the Pandacan oil depot. He was the Operations Manager from April 2003 to March 2005. In his 36 years of stay in the Company, he assumed various managerial positions such as Business Development Manager of the Corporate Planning Division, Sales Director, Retail Trade of the Marketing Division, Refinery Manager of Petron Bataan Refinery and Pandacan Terminal Manager. He graduated Magna Cum Laude with a Bachelor of Science degree in Mechanical Engineering from the National University.

Alfred A. Trio, Filipino, 57 years old, has been the Vice President for Refinery Division since December 1, 1999 and is a Trustee of the Petron Foundation, Inc.. Prior to his appointment as Vice President, he was the Reseller Trade Manager. He was hired as OM&S Technician at BRC Operations Department in January 1971. He gradually rose from the ranks to become Process Engineer (1979), Operations Shift Superintendent (1981), OM&S Superintendent (1984), and Engineering Department Manager (1987). By 1990, he was transferred to PNOC-EDC Operations Bacman Geothermal Project as Administrative Manager, and assumed various managerial positions in the Refinery. He attended the Asian Institute of Management's Top Management Program in 1998 and the Saudi Aramco Management Development Program in Washington, D. C. in 2001. He has been with the Company for 36 years. He holds a Bachelor of Science degree in Chemical Engineering.

Jose Jesus G. Laurel, Filipino, 52 years old, is currently the General Counsel (since May 12, 2005) and Vice President for Legal and External Affairs (since July 26, 2005). He is also Director of New Ventures Realty Corporation and Las Lucas Development Corporation and Trustee/Vice President of Petron Foundation, Inc.. Prior to Petron, he joined PNOC Energy Development Corporation in 1992 as General Counsel & Corporate Secretary (1992-2001) and as its Vice President for Corporate Services (Law/HR/Finance/Planning/Purchasing from 2001-2005) and was promoted to Vice President/Chief Operating Officer. He was also General Counsel and Corporate Secretary of the PNOC Coal Corporation and PNOC Exploration Corporation (1992-1999). Prior to this, he worked with the Securities & Exchange Commission (SEC) from 1982 to 1992 as Hearing Officer and later Deputy Executive Director. Atty. Laurel holds an A.B. Economics degree from the Ateneo de Manila University and an LL.B degree also from Ateneo de Manila University (2nd Honors/Silver Medal). He is a 6th-place Bar examinations topnotcher and holds a Master of Laws degree from Yale Law School, Yale University, New Haven, Connecticut, USA.

Sulaiman M. Ababtain, Saudi Arabian, 40 years old, was appointed Officer-in-Charge on September 7, 2005 and elected Vice President for Corporate Planning on November 30, 2005. He has 17 years experience with Saudi Aramco during which he held several managerial positions in Hydrocarbon Supply Planning, Operations, and Sales & Marketing. Before joining Petron, Mr. Ababtain was the Division Head of the Global Crude Oil Sales Coordination Division of Crude Oil Sales & Marketing Dept. He also headed the Maintenance and Operations Divisions of Northern Area Pipelines Department as well as Gas & NGL, Oil, and Terminal Divisions of Oil Supply Planning & Scheduling Department (OSPAS). He had also worked with upstream operations as Superintendent of Central Arabia Producing Division. His major work highlights include: having coordinated the introduction of AXL Crude at Juaymah Terminal, the introduction of Sales Gas into the 48" East/West pipeline to Yanbu Industrial Area, and improving the time in port and shiphandling performance at RT & Juaymah Terminals. He has a Bachelor's degree in System Engineering (1988) from King Fahad University of Petroleum & Minerals at Dhahran, Saudi Arabia and a Masters degree in Industrial Engineering (1996) from Purdue University, Indiana, USA.

Ma. Concepcion F. de Claro, Filipino, 49 years old, has been the Accounting Manager since April 2003 and is currently the Controller of the Company as well as its subsidiaries, namely, Petrogen Insurance Corporation, New Ventures Realty Corporation, Petron Foundation, Incorporated, Petron Marketing Corporation and Petron Freeport Corporation. She is also the Controller of Las Lucas Development Corporation, a subsidiary of the New Ventures Realty Corporation. She has been with the Company for 25 years. She started as a Financial Analyst and held several supervisory positions at the PNOC Energy Development Corporation (PNOC EDC), a former affiliate of Petron. After 11 years in PNOC EDC's Finance Division, Ms. De Claro transferred to PNOC's Budget and Control Department, where she was a Supervisor for three years before she was assigned to Petron's Corporate Planning Department when the Company was privatized in 1994. She was the Planning Officer for the Department for seven years, after which she became the Manager for Strategic Planning. She graduated Magna Cum Laude with a degree in Bachelor of Science in Commerce, major in Accounting from the Colegio de San Juan de Letran.

Rosario R. Eijansantos, Filipino, 58 years old, was appointed Manager of Treasurer's Department in April 2001 and elected Treasurer of the Company last May 8, 2001. She is also the Treasurer of New Ventures Realty Corporation, Petron Foundation Inc., Petrogen Insurance Corporation, Petron Marketing Corporation, Petron Freeport Corporation and Las Lucas Development Corporation, a subsidiary of NVRC. She has been with the Company for 35 years and has held managerial positions in Controllers, Internal Audit and Human Resources. She has a Bachelor of Science in Commerce degree major in Accounting, Cum Laude from the Far Eastern University and is a Certified Public Accountant.

Luis A. Maglaya, Filipino, 52 years old, has been the Corporate Secretary since July 28, 2003 and was appointed thereafter as Compliance Officer. He is also the Corporate Secretary of Petron Foundation, Inc., Petrogen Insurance Corp., New Ventures Realty Corporation, Petron Marketing Corporation and Petron Freeport as well as Las Lucas Development Corporation. He has been with the Company for 23 years. He held the position of Legal Counsel and Assistant Corporate Secretary from 1994 to 2003. He earned his Bachelor of Arts degree in Political Science from Ateneo de Manila University in 1975. He obtained his law degree from the University of the Philippines in 1980.

(3) Significant Employees

There is no significant employee or personnel who is not an executive officer but is expected to make a significant contribution to the business.

(4) Family Relationships

None of the directors or executive officers is in any way related between and among each other, either by consanguinity or affinity.

(5) Involvement in Certain Legal Proceedings

None of the directors and executive officers have been the subject of bankruptcy petitions or pending criminal proceedings or have been by judgment or decree found to have violated securities or commodities law and enjoined from engaging in any business, securities, commodities or banking activities.

(B) Executive Compensation

(1) Executive Compensation

Standard Arrangements.

Petron's Executive Officers are also regular employees of the company and are similarly remunerated with a compensation package comprising of twelve (12) months base pay. They also receive whatever gratuity pay the Board extends to the managerial, supervisory and technical employees of the company.

The members of the Board of Directors who are not Executive Officers are elected for a term of one year. They receive remuneration for 12 months in Director's fees and gas allowance, in addition to compensation on a per meeting participation.

Other Arrangements

There are no other arrangements for which the directors are compensated.

Employment Contract

In lieu of an employment contract, the Directors are elected at the annual meeting of stockholders for a one (1) year term. Any director elected in the interim will serve for the remaining term until the next annual meeting.

Summary Compensation Table

Compensation of Executive Officers and Directors		
Name	**Prinicipal Position**	**Amount (In Million Pesos)**
Nicasio I. Alcantara	Chairman/Chief Executive Officer	
Khalid D. Al-Faddagh	President	
Sulaiman M. Ababtain	Vice President - Corporate Planning	
Felimon E. Antiporta	Vice President - Supply & Operations	
Jose K. Campos, Jr.	Vice President - Marketing	
Jose Jesus G. Laurel	Vice President - Legal & External Affairs	
Antonio G. Pelayo	Vice President - Finance & Subsidiaries	
Alfred A. Trio	Vice President - Refinery	
Concepcion F. de Claro	Controller	
Rosario R. Eijansantos	Treasurer	
Luis A. Maglaya	Corporate Secretary	
TOTAL (Top 5 Executives)	Aggregate (2005-2006)	120.91
TOTAL (All Executives & Directors)	Aggregate (2005-2006)	204.00
Estimates:		
Estimate (Top 5 Executives)	Aggregate (2006-2007)	128.41
Estimate (All Executives/Directors)	Aggregate (2006-2007)	213.40

(C) Security Ownership of Certain Beneficial Owners and Management as of March 31, 2007

Security Ownership of Certain Record and Beneficial Ownership

Title of Class	Name & Address of record owner and relationship with issuer	Name of Beneficial Owner & relationship with record owner	Citizenship	No. of shares held	Percent
Common Stocks	Philippine National Oil Co.* PNPC Complex, Merritt Road, Fort Bonifacio, Taguig City, M.M. Major Stockholder	Philippine National Oil Company- Proxy- PNOC Chairman, Raphael Lotilla, Sec. of Dept of Energy	Filipino	3,750,000,007 (r)	40%
Common Stocks	Aramco Overseas Company B.V. ** PO Box 5000, Dhahran 31311, Saudi Arabia Major Stockholder	Aramco Overseas Co. B.V. Proxy- Khalid G. Al-Buainain, Vice President for Refining of Saudi Aramco	Netherlands	3,750,000,006 (r)	40%
Common Stocks	PCD Nominee Corporation (Foreign)*** G/F MSE Bldg., 6767 Ayala Avenue Makati City		Foreign	578,918,797 (r)	6.18%
Common Stocks	PCD Nominee Corporation (Filipino)*** G/F MSE Bldg., 6767 Ayala Avenue Makati City		Filipino	570,196,008 (r)	6.08%

* Beneficial owner is the government of the Republic of the Philippines through the Philippine National Oil Company (PNOC). Shares are voted upon by the proxy of PNOC.

** Beneficial owner is Saudi Aramco which is owned by the Kingdom of Saudi Arabia. Shares are voted upon by the proxy designated by Aramco Overseas Company, B.V.

*** PCD Nominee Corporation, a wholly owned subsidiary of Philippine Central Depository, Inc. (PCD), is the registered owner of the shares in the books of the company's transfer agent in the Philippines. The beneficial owners of such shares are PCD's participants, who hold the shares on their behalf or in behalf of their clients. PCD is a private company organized by the major institutions actively participating in the Philippines capital market to implement an automated book-entry system of handling securities transactions in the Philippines.

(1) Security Ownership of Management as of March 31, 2007

Title of Class	Name of Beneficial Owner	Amount & Nature of Beneficial Ownership (Indicate by "d" or "I")	Citizenship	Percent of Class
Directors				
Common Stock	Nicasio I. Alcantara	1,238,705 (d)	Filipino	0.013%
Common Stock	Khalid D. Al-Faddagh	1 (d)	Saudi Arabian	Nil
Common Stock	Basil A. Abul-Hamayel	1,000 (d)	Saudi Arabian	Nil
Common Stock	Bernardino R. Abes	1 (d)	Filipino	Nil
Common Stock	Khalid G. Al-Buainain	1 (d)	Saudi Arabian	Nil
Common Stock	Herminio S. Aquino	15,000 (d)	Filipino	Nil
Common Stock	Alberto A. Pedrosa	1 (d)	Filipino	Nil
Common Stock	Abdullah O. Al-Baiz	1 (d)	Saudi Arabian	Nil
Common Stock	Douhan H. Al-Douhan	1,000 (d)	Saudi Arabian	Nil
Common Stock	Emilia T. Boncodin	3,000 (d)	Filipino	Nil
Executive Officers				
Common Stock	Alfred A. Trio	263,313 (d)	Filipino	0.003%
Common Stock	Jose K. Campos, Jr.	682,478 (d)	Filipino	0.007%
Common Stock	Antonio G. Pelayo	158,668 (d)	Filipino	0.002%
Common stock	Jose Jesus G. Laurel	10,000 (d)	Filipino	Nil
Common stock	Felimon E. Antiporta	258,350 (d)	Filipino	0.002%
Common Stock	Sullaiman M. Ababtain	0 (d)	Saudi Arabian	Nil
Common Stock	Rosario R. Eijansantos	235,689 (d)	Filipino	0.003%
Common Stock	Ma. Concepcion F. de Claro	22,513 (d)	Filipino	Nil
Common Stock	Luis A. Maglaya	68,550 (d)	Filipino	0.001%

As of March 31, 2007, the total number of shares owned by the Directors and officers is 2,958,271**.**

(2) Voting Trust Holders of 10% or more

There is no voting trust between PNOC and AOC.

(3) Changes in Control

There is no arrangement which may result in a change in control of the company.

(D) Certain Relationships and Related Transactions

1. The long-term leases between PNOC and Petron since 1994 over various parcels of land.
2. The "Parents" of the company are**:**

(a) Philippine National Oil Co. - 40%
(b) Aramco Overseas Co. B.V. - 40%

The basis of control is the number of the percentage of voting shares held by each.

(E) Corporate Governance

Petron's Board of Directors is composed of ten (10) members, two (2) of whom are Independent Directors. Currently, only two (2) of the members are Executive Directors, occupying the positions of the Chairman and the President of the company. Petron Directors sign Conflict-of-Interest Statements, disclosing their respective business interests, to ensure that these are not in competition with the business of Petron. The schedule of board meetings for the entire year is fixed at the start of the year and board materials are given not later than two weeks prior to every meeting. All Directors, officers and senior managers are required to attend basic corporate governance seminar immediately upon assuming office.

To instill a stable and transparent process of conducting its business and at the same time identifying accountability at all times, a system of approvals is in place whereby only authorized officer(s) may approve a particular business transaction and only up to the authorized amount. Transactions with amounts exceeding the joint approval limit of the Chairman and the President are elevated to the Board for approval. Aside from the Corporate Governance Manual, several other manuals have been instituted by Management to establish company policies and guide the employees in carrying out their respective functions and duties, address business operations, set contracting and bidding procedures, and instill business ethics, office decorum and employee discipline.

Management continuously conducts periodic assessment through quarterly management reviews as well as quarterly safety reviews in order to check on business performance i.e. actuals vis-à-vis targets as well as compliance with business parameters and/or financial parameters and health, safety and environmental requirements.

Reports required to be given to the stockholders pursuant to its By-Laws and the Securities and Regulation Code and submissions to the SEC/PSE, including quarterly financial reports, annual report and disclosures, GIS, request for explanation or information on news items are complied with. The company sees to it that queries or requests from shareholders are immediately attended to and that written communications, including notices of stockholders meetings, are properly sent. Pursuant to the requirements of the Securities and Exchange Commission, the Corporate Secretary and Compliance Officer has submitted in January 2007 the required yearly certification to the SEC on the compliance by the company with its Corporate Governance Manual.

With the election of 2 independent Directors to the Petron Board; the election of members and alternate members, in proper cases, of the Audit, Compensation and Nomination Committees; the conduct of regular quarterly board meetings, special board meetings and board committee meetings and the faithful attendance of and proper discharge of duties and responsibilities of Directors at such meetings; the conduct of training/seminar for Corporate Governance for incoming Directors and Officers; and strict adherence to national and local laws pertaining to its business operations, including applicable accounting standards and disclosure requirements, the company is in compliance with its Corporate Governance Manual.

List of Directors

(As of December 31, 2006)

#	Directors	Executive/ Non-Executive/ Independent Director	Attended Corporate Governance Seminar	Attendance to Meeting							Committee Membership		
				28-Feb	4-Apr	19-May	27-Jul	27-Jul i	28-Jul ii	10-Nov	Nomi-nation iii	Audit iv	Compen-sation v
1	Nicasio I. Alcantara	Executive Director	x	x	x	x	x	x	x	x	x		Chairman (non-voting
2	Khalid D. Al-Faddagh	Executive Director	x	x	x	x	x	x	x	x	x		non-voting
3	Khalid G. Al-Buainain	Non-Executive Director	x	x	x	x	x	x	x	x			x
4	Bernardino R. Abes	Non-Executive Director	x	x	x	x	x	x	x	x			x
5	Basil A. Abul-Hamayel	Non-Executive Director	x	x	x	x	x	x	x	x	x	x	
6	Herminio S. Aquino	Non-Executive Director	x	x	x	x	x	x	x	x		x	
7	Ahmad O. Al-Khowaiter	Non-Executive Director	x	x	x	x	x	x	x				x
8	Alberto A. Pedrosa	Non-Executive Director	x	x	x	x	x	x	x	x	x		
9	Douhan H. Al-Douhan	Independent Director	x	x	x	x	x	x	x	x	x	x	x
10	Emilia T. Boncodin	Independent Director	x*	x**		x	x	x	x	x	Chair person	Chair person	x

Notes:

i Annual Stockholders' Meeting

ii Organizational/Regular Board Meeting

iii Meeting Date: May 11, 2006

iv Meeting Dates: February 27, 2006; April 4, 2006; May 19, 2006; July 27, 2006; November 9, 2006

v Meeting Dates: February 27, 2006; May 19, 2006; July 27, 2006; November 9, 2006

* Director Boncodin teaches Corporate Governance at the UP National College of Public Administration and Governance in Diliman

** Attended by former Independent Director Jose Luis U. Yulo; Director Boncodin was elected on april 4, 2006

PART V - EXHIBITS AND SCHEDULES

Item 14. Exhibits and Reports on SEC Form 17-C

Exhibits

Exhibit 1 - Audited Financial Statements
Exhibit 2 - Index to Financial Statements & Supplementary Schedules

Reports on SEC Form 17-C

1. Contract Award for the Engineering, Procurement and Construction (EPC) of the PetroFCC Project in favor of Daelim Industrial Ltd. in the total amount of US$178.4 million.
2. Ratification of the Supplemental Budget and Contract Award for the Engineering, Procurement and Construction (EPC) of the PetroFCC Project in favor of Daelim Industrial Ltd. in the total amount of US$178.4 million.
3. Inter-company advance of P125 million for service station lot acquisitions thru New Ventures Realty Corporation, Petron's real estate arm.
4. Funding in the amount of P450.4 million for its major capital program.
5. Appointment of Director Basil Abul-Hamayel as new member of the Board Audit Committee, in lieu of Director Ahmad O. Al-Khowaiter and the acceptance by the Board of the resignation of Director Jose Luis U. Yulo, Jr., Independent Director, effective March 1, 2006.
6. Disclosure of 2005 unaudited net income of P6.04 billion for the full year 2005.
7. Election of Ms. Emilia. T. Boncodin as Independent Director effective April 4, 2006. Ms. Boncodin was also elected as Chairperson of the Nomination and Audit Committees and Member of the Compensation Committee.
8. Authority to borrow long-term the amount of US$200 million or its peso equivalent to fund its PetroFCC and related projects.
9. 2005 Financial Statements posting a net income of P6.05 billion.
10. Contract Award for the Engineering, Procurement and Construction (EPC) of Propylene Storage and Loading Facilities.
11. Authorization for the Chairman and the President to jointly award the PetroFCC Miscellaneous Support Facilities.
12. Appointment of Independent Director Douhan H. Al-Douhan as regular member of the Board Compensation Committee and Mr. Basil A. Abul-Hamayel as alternate member.
13. Fixing the date of Annual Stockholders' Meeting on July 27, 2006.
14. Setting the record date for the list of qualified stockholders on June 2, 2006 and closing of stock transfer books from June 3 to June 10, 2006.
15. Endorsement of nominees and final list of candidates for Independent Directors.
16. Approval of the Agenda for the Annual Stockholders' Meeting on July 27, 2006.
17. Increase in members of the Board Compensation Committee from four to five regular members, two of whom are Independent Directors.
18. Ratification of the 1st Quarter 2006 Financial Performance Report and Financial Statements showing a net income of P1.01 billion.
19. Declaration of cash dividend of P0.10 per share to stockholders of record as of the close of trading hours on June 2, 2006, payable on June 29, 2006.
20. Approval of the Interim Financial Report for the first half of 2006 showing a consolidated net income of P2.69 billion.
21. Re-appointment of Sycip, Gorres and Velayo as independent auditor for 2006.
22. Election of Directors of Petron Corporation.
23. Approval of the Supplemental Budget for the 2006 AutoLPG Program in the amount of P50.6 million.

24. Funding request in the amount of P59.5 million for the Refinery firewater and rationalization and capability upgrade in compliance with NFPA standards requiring the installation of fire-fighting facilities at the Refinery.
25. Cancellation of prior years' unused major capital budgets.
26. Signing of the Fixed Rate Corporate Notes (FXCN) Facility Agreement amounting to P6.3 billion.
27. Clarification on the news article concerning a tax case of Petron. The Court of Tax Appeals (CTA) rendered its decision on Case No. 6136 wherein it ruled that Petron's payment thru tax credit certificates (TCCs) did not produce effect of payment, thereby ordering Petron to pay P580,236,552.67 as deficiency excise taxes for 1995 to 1997, plus 20% as delinquency interest per annum computed from December 4, 1999. Petron maintained that it will pursue all legal remedies available.
28. Ratification of the contract extension for the Data & Voice Consolidated Project with PLDT/Smart.
29. Endorsement of the 2007-2011 Business Plan and 2007 Capital Program in the amount of P5.022 billion.
30. 2007 Operating Expense Budget in the amount of P9.658 billion.
31. Miscellaneous Capital Budget in the amount of P582.7 million.
32. Setting up of appropriated retained earnings of P17.021 billion for fiscal year ending December 31, 2006.
33. Funding requests for the Boiler Tube Replacement; 2007 AutoLPG Program and; 2007 Service Station Funds Pool.
34. Approval of the inter-company advance to NVRC for Service Station Lot Funds Pool.
35. Proposal for fuel additive blending with Innospec.
36. 3rd Quarter 2006 Financial Statements showing a net income of P4 billion.
37. Attendees to Petron Board Meetings for 2006.

The company also submitted the following press releases:

1. Press Release on March 20, 2006 entitled "Petron Posts P6.05-B Net Income for 2005".
2. Press Release on May 12, 2006 entitled "Petron Posts More Than a Billion for 1Q 2006".
3. Press Release on July 3, 2006 entitled "Petron Remits P375-Million to Philippine National Oil Company".
4. Press Release on July 25, 2006 entitled "Petron's Corporate Notes Issue Heavily Oversubscribed".
5. Press Release on July 27, 2006 entitled "Petron Posts 16% Growth in Net Income for 1st half 2006".
6. Press Release on July 31, 2006 entitled "Due to Increased Demand, Petron Upsizes Notes Issue to P6.3-Billion".
7. Press Release on November 10, 2006 entitled "Petron Posts P4-B Net Income for YTD September 2006".

SIGNATURES

Pursuant to the requirements of Section 17 of the Code and Section 141 of the Corporation Code, this report is signed on behalf of the issuer by the undersigned, thereunto duly authorized, in the City of Makati on APR 16 2007, 2007.

By:

NICASIO I. ALCANTARA
Chairman/Chief Executive Officer

KHALID D. AL-FADDAGH
President

MA. CONCEPCION F. DE CLARO
Controller

LUIS A. MAGLAYA
Corporate Secretary

SUBSCRIBED AND SWORN to before me this_____ day of APR 16 2007 2007 affiant(s) exhibiting to me his/their Community Tax Certificates, as follows:

NAMES	CTC#	DATE OF ISSUE	PLACE OF ISSUE
Nicasio I. Alcantara	17665184	January 24, 2007	Makati City
Khalid D. Al-Faddagh	17708080	February 23, 2007	Makati City
Ma. Concepcion F. de Claro	05824079	January 5, 2007	Mandaluyong City
Luis A. Maglaya	18340503	February 27, 2007	Quezon City

ROMMEL L. BAYALAN
Notary Public for Makati City
Notary Commission No. M-218
Until December 31, 2007
Notary Public
PTR No. 0267946 1.3.07 Makati
IBP No. 705666 1.25.07 Pasig
Roll of Attorney No. 42921
PETRON Mega Plaza Bldg.,
358 Sen. Gil Puyat Ave., Makati City

Doc. No. 141
Page No. 30
Book No. XI
Series of 2007.

1

PETRON CORPORATION AND SUBSIDIARIES

Consolidated Financial Statements
December 31, 2006 and 2005
and Years Ended December 31, 2006, 2005 and 2004

and

Independent Auditors' Report

COVER SHEET

3 1 1 7 1

SEC Registration Number

P E T R O N C O R P O R A T I O N A N D S U B S I D I A R I E S

(Company's Full Name)

P e t r o n M e g a P l a z a , 3 5 8 S e n . G i l P u y a t A v e n u e , M a k a t i C i t y

(Business Address: No. Street City/Town/Province)

Luis A. Maglaya	**886-3888**
(Contact Person)	(Company Telephone Number)

1 2	**3 1**	**A A C F S**		
Month	*Day*	(Form Type)	*Month*	*Day*
(Fiscal Year)			(Annual Meeting)	

(Secondary License Type, If Applicable)

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

S T A M P S

Remarks: Please use BLACK ink for scanning purposes.

SGVMC209078

SGV & Co

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

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

BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-F

INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of Petron Corporation and Subsidiaries, which comprise the consolidated balance sheets as at December 31, 2006 and 2005, and the consolidated statements of income, consolidated statements of recognized income and expense and consolidated statements of cash flows for each of the three years in the period ended December 31, 2006, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with Philippine Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with Philippine Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Petron Corporation and Subsidiaries as of December 31, 2006 and 2005, and their financial performance and their cash flows for each of the three years in the period ended December 31, 2006 in accordance with Philippine Financial Reporting Standards.

SYCIP GORRES VELAYO & CO.

Wilson P. Tan

Wilson P. Tan
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-AR-1
Tax Identification No. 102-098-469
PTR No. 0267394, January 2, 2007, Makati City

April 3, 2007

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in Millions)

	December 31	
	2006	2005
ASSETS		
Current Assets		
Cash and cash equivalents (Note 4)	**₱11,735**	₱3,940
Financial assets at fair value through profit or loss (Note 5)	**180**	116
Available-for-sale investments (Note 6)	**103**	259
Receivables - net (Note 7)	**15,629**	11,863
Inventories - net (Notes 8, 23 and 26)	**26,289**	27,018
Other current assets - net (Note 30)	**7,054**	1,297
Total Current Assets	**60,990**	44,493
Noncurrent Assets		
Available-for-sale investments (Note 6)	**529**	327
Property, plant and equipment - net (Note 9)	**25,153**	22,570
Investment properties - net (Note 10)	**222**	235
Other noncurrent assets - net (Notes 11, 22 and 25)	**622**	1,261
Total Noncurrent Assets	**26,526**	24,393
	₱87,516	₱68,886
LIABILITIES AND EQUITY		
Current Liabilities		
Short-term loans (Note 12)	**₱28,135**	₱21,407
Liabilities for crude oil and petroleum product importation (Note 23)	**7,541**	7,911
Accounts payable and accrued expenses (Notes 13 and 30)	**3,731**	2,626
Income tax payable	**452**	183
Current portion of long-term debt - net (Note 14)	**1,633**	1,906
Total Current Liabilities	**41,492**	34,033
Noncurrent Liabilities		
Long-term debt - net of current portion (Note 14)	**11,279**	5,025
Deferred income tax liabilities - net (Note 22)	**1,443**	1,516
Other noncurrent liabilities (Note 15)	**1,049**	697
Total Noncurrent Liabilities	**13,771**	7,238
Equity Attributable to Equity Holders of the Parent (Note 16)		
Capital stock	**9,375**	9,375
Retained earnings:		
Appropriated	**17,021**	11,652
Unappropriated	**6,232**	6,352
Other reserves	**(490)**	128
Equity Attributable to Equity Holders of the Parent	**32,138**	27,507
Minority Interest (Note 16)	**115**	108
Total Equity	**32,253**	27,615
	₱87,516	₱68,886

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Amounts in Millions, Except Per Share Amounts)

	Years Ended December 31		
	2006	2005	2004
SALES (Notes 26 and 32)	**₱211,726**	₱191,489	₱147,425
COST OF GOODS SOLD (Notes 8, 17, 19, 20, 23, 25 and 26)	**197,514**	177,210	135,398
GROSS PROFIT	**14,212**	14,279	12,027
SELLING AND ADMINISTRATIVE EXPENSES (Notes 18, 19, 20, 23, 25 and 33)	**(4,485)**	(4,527)	(4,877)
INTEREST EXPENSE (Notes 12, 14, 15 and 21)	**(2,684)**	(2,091)	(1,675)
INTEREST INCOME (Note 21)	**362**	317	344
OTHERS - Net (Notes 5, 15, 21, 23 and 30)	**499**	164	(395)
INCOME BEFORE INCOME TAX	**7,904**	8,142	5,424
PROVISION FOR (BENEFIT FROM) INCOME TAX (Notes 22 and 31)			
Current	**1,723**	2,057	1,339
Deferred	**163**	34	(16)
	1,886	2,091	1,323
NET INCOME (Note 16)	**6,018**	₱6,051	₱4,101
Attributable to:			
Equity holders of the parent (Note 27)	**₱6,011**	₱6,044	₱4,094
Minority interest	**7**	7	7
	₱6,018	₱6,051	₱4,101
BASIC EARNINGS PER SHARE ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT (Note 27)	**₱0.64**	₱0.64	₱0.44

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF RECOGNIZED INCOME AND EXPENSE

(Amounts in Millions)

	Years Ended December 31		
	2006	2005	2004
Actuarial gain (loss) on defined pension plan (Note 25)	**(₱699)**	₱356	₱286
Tax effect	**242**	(133)	(92)
Net actuarial gain (loss) on defined pension plan	**(457)**	223	194
Actuarial loss (gain) due to limit on recognized plan assets [net of tax effects of ₱93, ₱212 and ₱53 in 2006, 2005 and 2004, respectively (Notes 16 and 25)]	**(176)**	(408)	115
	(633)	(185)	309
Unrealized fair value gain on available-for-sale investments [net of tax effects of ₱8 and ₱4 in 2006 and 2005, respectively (Note 6)]	**15**	4	–
NET INCOME (LOSS) RECOGNIZED DIRECTLY IN EQUITY	**(618)**	(181)	309
NET INCOME FOR THE YEAR (Note 16)	**6,018**	6,051	4,101
TOTAL RECOGNIZED INCOME AND EXPENSE FOR THE YEAR	**₱5,400**	₱5,870	₱4,410
Attributable to:			
Equity holders of the parent	**₱5,393**	₱5,863	₱4,403
Minority interest	**7**	7	7
	₱5,400	₱5,870	₱4,410

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in Millions)

	Years Ended December 31		
	2006	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES			
Income before income tax	**₱7,904**	₱8,142	₱5,424
Adjustments for:			
Interest expense (Note 21)	**2,684**	2,091	1,675
Depreciation and amortization (Notes 9, 10 and 20)	**2,482**	2,335	1,856
Unrealized foreign exchange loss (gain) - net	**(382)**	(270)	48
Interest income (Note 21)	**(362)**	(317)	(344)
Others	**(131)**	(111)	–
Operating income before working capital changes	**12,195**	11,870	8,659
Changes in operating assets and liabilities (Note 28)	**(4,282)**	(6,326)	(6,093)
Interest paid	**(2,383)**	(2,047)	(1,643)
Income taxes paid	**(1,454)**	(1,850)	(1,075)
Interest received	**352**	316	343
Net cash provided by operating activities	**4,428**	1,963	191
CASH FLOWS FROM INVESTING ACTIVITIES			
Additions to:			
Property, plant and equipment (Note 9)	**(5,052)**	(2,313)	(5,463)
Investment properties (Note 10)	**–**	(16)	–
Decrease (increase) in:			
Other receivables	**(3,943)**	9	209
Other noncurrent assets	**(61)**	(67)	(182)
Reductions from (additions to):			
Financial assets at fair value through profit or loss	**1**	2	–
Available-for-sale investments	**(24)**	(249)	–
Short-term investments	–	–	19
Net cash used in investing activities	**(9,079)**	(2,634)	(5,417)
CASH FLOWS FROM FINANCING ACTIVITIES			
Availments of loans	**157,460**	78,246	80,854
Payments of:			
Loans	**(144,433)**	(76,879)	(72,949)
Cash dividends	**(928)**	(925)	(1,846)
Others	**378**	78	101
Net cash provided by financing activities	**12,477**	520	6,160
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	**(31)**	(13)	(28)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	**7,795**	(164)	906
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**3,940**	4,104	3,198
CASH AND CASH EQUIVALENTS AT END OF YEAR (Note 4)	**₱11,735**	₱3,940	₱4,104

See accompanying Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1. Corporate Information

Petron Corporation (the Parent Company or Petron) was incorporated under the laws of the Republic of the Philippines and registered with the Philippine Securities and Exchange Commission (SEC) on December 15, 1966. Petron is the largest oil refining and marketing company in the Philippines, supplying more than one-third of the country's oil requirements. The Company is dedicated and passionate about its vision to be the leading provider of total customer solutions in the energy sector and its derivative businesses.

Petron operates a refinery in Limay, Bataan, with a rated capacity of 180,000 barrels a day. Petron's International Standards Organization (ISO)-14001 - certified refinery processes crude oil into a full range of petroleum products including LPG, gasoline, diesel, jet fuel, kerosene, industrial fuel oil, solvents, asphalts, and mixed xylene. From the refinery, Petron moves its products mainly by sea to Petron's 32 depots and terminals situated all over the country. Through this nationwide network, Petron supplies fuel oil, diesel, and LPG to various industrial customers. The power sector is Petron's largest customer. Petron also supplies jet fuel at key airports to international and domestic carriers.

Through more than 1,200 service stations, the largest in the country, Petron retails gasoline, diesel and kerosene to motorists and public transport operators. Petron also sells its LPG brand "Gasul" to households and other consumers through an extensive dealership network.

Petron operates a state-of-the-art lube oil blending plant at Pandacan Oil Terminals, where it manufactures lubes and greases. These are also sold through Petron's service stations and sales centers.

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

In line with Petron's efforts to increase its presence in the regional market, it exports various petroleum products to Asia-Pacific countries such as Cambodia, Korea, China and Australia.

Petron is a public company under Section 17.2 of the Securities Regulation Code. The Philippine National Oil Company (PNOC) and the Aramco Overseas Company B.V. each owns a 40% share of equity. The remaining 20% is held by close to 200,000 stockholders.

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

The registered office address of Petron and its Philippine-based subsidiaries is Petron MegaPlaza, 358 Sen. Gil Puyat Avenue, Makati City.

The accompanying consolidated financial statements as of December 31, 2006 and 2005 and for each of the three years in the period ended December 31, 2006 were approved and authorized for issue by the Board of Directors (BOD) on April 3, 2007.

2. Summary of Significant Accounting Policies

Basis of Preparation
The accompanying consolidated financial statements of Petron and subsidiaries (collectively referred to as “the Company”) have been prepared on the historical cost basis, except for financial assets at fair value through profit or loss (FVPL), available-for-sale (AFS) investments and derivative financial instruments, which are measured at fair value. The consolidated financial statements are presented in Philippine pesos, which is the Company’s functional and presentation currency. All amounts are rounded to the nearest millions (₱000,000), except when otherwise indicated.

Statement of Compliance
The consolidated financial statements of the Company have been prepared in compliance with Philippine Financial Reporting Standards (PFRS).

Changes in Accounting Policies
The accounting policies adopted are consistent with those of previous financial year, except for the adoption of the following new and amended PFRS and Philippine Interpretations in 2006. Adoption of these new and amended standards and interpretations did not have any significant effect on the Company’s consolidated financial statements. These, however, require additional disclosures on the consolidated financial statements.

- Philippine Accounting Standard (PAS) 21, Amendment - “The Effects of Changes in Foreign Exchange Rates”;
- PAS 39, Amendments - “Financial Instruments: Recognition and Measurement”; and
- Philippine Interpretation IFRIC 4, “Determining Whether an Arrangement Contains a Lease.”

The Company has also early adopted the following Philippine Interpretations. Adoption of these interpretations did not have any significant effect on the financial position of the Company.

- Philippine Interpretation IFRIC 8, “Scope of PFRS 2”;
- Philippine Interpretation IFRIC 9, “Reassessment of Embedded Derivatives”; and
- Philippine Interpretation IFRIC 10, “Interim Financial Reporting and Impairment.”

The following Philippine Interpretations are effective for annual periods beginning on or after January 1, 2006 but are not relevant to the Company:

- Philippine Interpretation IFRIC 5, “Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds”; and
- Philippine Interpretation IFRIC 6, “Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment.”

The principal effects of these changes are as follows:

a. PAS 21, "The Effects of Changes in Foreign Exchange Rates." The Company adopted the amendments to PAS 21. All exchange differences arising from a monetary item that forms part of the Company's net investment in a foreign operation are recognized in a separate component of equity in the consolidated financial statements regardless of the currency in which the monetary item is denominated. This change has no significant impact on the consolidated financial statements.

b. PAS 39, "Financial Instruments: Recognition and Measurement." Amendment for financial guarantee contracts - amended the scope of PAS 39 to require financial guarantee contracts that are not considered to be insurance contracts to be recognized initially at fair value and to be remeasured at the higher of the amount determined in accordance with PAS 37, "Provisions, Contingent Liabilities and Contingent Assets," and the amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with PAS 18, "Revenue." This amendment did not have an effect on the consolidated financial statements.

   Amendment for hedges of forecast intra-group transactions - amended PAS 39 to permit the foreign currency risk of a highly probable intra-group forecast transaction to qualify as the hedged item in a cash flow hedge, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect the consolidated statement of income. As the Company currently has no such transactions, the amendment did not have an effect on the consolidated financial statements.

   Amendment for the fair value option - amended PAS 39 to restrict the use of the option to designate any financial asset or any financial liability to be measured at fair value through the consolidated statement of income. The Company has complied with these conditions.

c. Philippine Interpretation IFRIC 4, "Determining Whether an Arrangement Contains a Lease." This interpretation provides guidance in determining whether arrangements contain a lease to which lease accounting must be applied. This change in accounting policy has no significant impact on the consolidated financial statements.

d. Philippine Interpretation IFRIC 5, "Rights to Interests Arising from Decommissioning, Restoration and Environmental Rehabilitation Funds." This interpretation establishes the accounting treatment for funds established to help finance decommissioning for companies assets. As the Company does not currently operate in a country where such funds exist, this interpretation has no impact on the consolidated financial statements.

e. Philippine Interpretation IFRIC 6, "Liabilities Arising from Participating in a Specific Market - Waste Electrical and Electronic Equipment." This interpretation establishes the recognition date for liabilities arising from the EU Directive relating to the disposal of waste electrical and electronic equipment. This interpretation is not applicable to the Company as it has no operations in countries covered by the EU Directive.

f. Philippine Interpretation IFRIC 8, "Scope of PFRS 2." This interpretation requires PFRS 2 to be applied to any arrangements where equity instruments are issued for consideration which appears to be less than fair value. This interpretation has no impact on the financial position of the Company.

g. Philippine Interpretation IFRIC 9, "Reassessment of Embedded Derivatives." This interpretation establishes that the date to assess the existence of an embedded derivative is the date an entity first becomes a party to the contract, with reassessment only if there is a change to the contract that significantly modifies the cash flows. The Company has assessed that adoption of this interpretation has no impact on the consolidated financial statements.

h. Philippine Interpretation IFRIC 10, "Interim Financial Reporting and Impairment." This interpretation which provides that the frequency of financial reporting does affect the amount of impairment charge to be recognized in the annual financial reporting with respect to goodwill and AFS investments. It prohibits the reversal of impairment losses on goodwill and AFS investments recognized in the interim financial reports even if impairment is no longer present at the annual balance sheet date. This interpretation has no significant impact on the consolidated financial statements of the Company.

Basis of Consolidation

The consolidated financial statements comprise the financial statements of the Parent Company and its subsidiaries as of December 31 of each year. The financial statements of the subsidiaries are prepared for the same reporting year as the Parent Company, using consistent accounting policies.

All significant intra-group balances, transactions, income and expenses and profits and losses resulting from intra-group transactions are eliminated in full in the consolidation.

Subsidiaries are fully consolidated from the date on which control is transferred to the Company or Parent Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Consolidation of subsidiaries ceases when control is transferred out of the Company or Parent Company.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of income from the date of acquisition or up to the date of disposal, as appropriate.

Minority Interests

Minority interests represent the portion of profit or loss and the net assets not held by the Company and are presented separately in the consolidated statement of income and within equity in the consolidated balance sheet, separately from parent shareholders' equity. Acquisitions of minority interests are accounted for using the entity concept method, whereby the difference between the consideration and the book value of the share of the net assets acquired is recognized as an equity transaction.

The consolidated subsidiaries include:

Subsidiaries	Percentage of Ownership	Country of Incorporation
Overseas Ventures Insurance Corporation (Ovincor)	100.00	Bermuda
Petrogen Insurance Corporation (Petrogen)	100.00	Philippines
Petron Freeport Corporation (PFC)	100.00	Philippines
Petron Marketing Corporation (PMC)	100.00	Philippines
New Ventures Realty Corporation (NVRC) and Subsidiary	79.95	Philippines

In the past, Petron, being partly foreign-owned, was not allowed by the Retail Trade Law to engage in direct retailing. Upon enactment of the Retail Trade Liberalization Act (RTLA) in 2000, the Philippine Board of Investments (BOI) has approved Petron's application to establish a retail enterprise, paving the way for the establishment of a direct-retailing subsidiary, PMC, on January 27, 2004. PMC operates COCO service stations. The COCO service stations will play a major part in launching market initiatives to strengthen the "Petron" brand and will give the Company the opportunity to quickly introduce innovations beyond the present services that are available in its service stations.

The primary purpose of PFC and PMC is to, among others, sell on wholesale or retail and operate service stations, retail outlets, restaurants, convenience stores and the like. NVRC's primary purpose is to acquire real estate and derive income from its sale or lease.

Petrogen and Ovincor are engaged in the business of non-life insurance and re-insurance.

Cash and Cash Equivalents

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

Financial Assets and Liabilities

Accounting Policies Effective January 1, 2005

Financial assets and liabilities are recognized initially at fair value. Transaction costs are included in the initial measurement of all financial assets and liabilities, except for financial instruments measured at FVPL.

The fair value of investments that are actively traded in organized financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's-length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis and option pricing models.

The Company recognizes a financial asset or liability in the consolidated balance sheet when it becomes a party to the contractual provisions of the instrument and derecognizes a financial asset when it no longer controls the contractual rights that comprise the financial instrument, which is normally the case when the instrument is sold, or all of the cash flows attributable to the instrument are passed to an independent third party. A financial liability (or a part of a financial liability) is derecognized when the obligation is extinguished. In the case of a regular way purchase or sale of financial assets, recognition and derecognition, as applicable, is done using settlement date accounting.

Financial instruments are classified as liabilities or equity in accordance with the substance of the contractual arrangement. Interest, dividends, gains and losses relating to a financial instrument or a component that is a financial liability, are reported as expense or income. Distributions to the holders of financial instruments classified as equity are charged directly to equity, net of any related income tax benefits. Financial instruments are offset when there is a legally enforceable right to offset and intention to settle either on a net basis or to realize the asset and settle the liability simultaneously.

Financial assets and liabilities are further classified into the following categories: financial assets or liabilities at FVPL, loans and receivables, held-to-maturity (HTM) investments and AFS investments. Financial liabilities that do not qualify as and are not designated at FVPL are subsequently carried at amortized cost using the effective interest method. The Company determines the classification at initial recognition and, where allowed and appropriate, re-evaluates this designation at every reporting date.

a. *Financial Assets or Liabilities at FVPL.* Financial assets or liabilities are classified in this category if acquired principally for the purpose of selling or repurchasing in the near term or upon initial recognition, it is designated by the management as FVPL. Financial assets or liabilities at FVPL are designated by management on initial recognition when the following criteria are met:

   - The designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the assets or liabilities or recognizing gains or losses on them on a different basis;

   - The assets and liabilities are part of a group of financial assets, financial liabilities or both which are managed and their performance 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 recorded.

   Derivatives are also categorized as held at FVPL, except those derivatives designated and considered as effective hedging instruments.

Financial assets and liabilities at FVPL are recorded in the consolidated balance sheet at fair value. Changes in fair value are accounted for in the consolidated statement of income. Interest earned or incurred is recorded as interest income or expense, respectively. Dividend income is recorded as other income according to the terms of the contract, or when the right of the payment has been established.

Classified as financial assets at FVPL are the Company's investments in marketable equity securities and proprietary membership shares (see Note 5). The Company has no financial liabilities at FVPL as of December 31, 2006 and 2005.

b. *Loans and Receivables.* Loans and receivables are non-derivative financial assets with fixed or determinable payments and are not quoted in an active market. Such assets are carried at cost or amortized cost in the consolidated balance sheet. Amortization is determined using the effective interest method and is included in the "Interest income" account in the consolidated statement of income. The losses arising from impairment of such financial assets are recognized in the consolidated statement of income.

Loans and receivables are included in current assets if maturity is within 12 months from the balance sheet date. Otherwise, these are classified as noncurrent assets.

Classified as loans and receivables are the Company's trade and other receivables (see Note 7).

c. *HTM Investments.* HTM investments are quoted non-derivative financial assets with fixed or determinable payments and fixed maturities for which the Company's management has the positive intention and ability to hold to maturity. Where the Company sell other than an insignificant amount of HTM investments, the entire category would be tainted and reclassified as AFS investments. After initial measurement, these investments are subsequently measured at amortized cost using the effective interest method, less any impairment in value. Amortized cost is calculated by taking into account any discount or premium on acquisition and fees that are an integral part of the effective interest rate. The amortization is included in "Interest income" account in the consolidated statement of income. Gains and losses are recognized in the consolidated statement of income when the HTM investments are derecognized and impaired, as well as through the amortization process. The losses arising from impairment of such investments are recognized in the consolidated statement of income. The effects of restatement on foreign currency denominated HTM investments are recognized in the consolidated statement of income.

Assets under this category are classified as current assets if maturity is within 12 months from the balance sheet date and as noncurrent assets if maturity date is more than a year from the balance sheet date.

The Company has no HTM investments as of December 31, 2006 and 2005.

d. *AFS Investments.* AFS investments are those which are designated as such or do not qualify to be classified as financial assets at FVPL, HTM investments or loans and receivables. They are purchased and held indefinitely, and may be sold in response to liquidity requirements or changes in market conditions. They may include equity investments, money market papers and other debt instruments.

After initial measurement, AFS investments are subsequently measured at fair value. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-denominated AFS debt securities, are reported in the consolidated statement of income. The unrealized gains and losses arising from the fair valuation of AFS investments, net of tax, are excluded from reported earnings and are reported under “Other reserves” account in the equity section of the consolidated balance sheet, until the investment is derecognized or until the investment is determined to be impaired at which time the cumulative gains or losses previously reported in equity are included in the consolidated statement of income.

Where the Company holds more than one investment in the same security, these are deemed to be disposed of on a first-in, first-out basis. Interest earned on holding AFS investments are reported as interest income using the effective interest rate. Dividends earned on holding AFS investments are recognized in “Other income” account in the consolidated statement of income when the right of the payment has been established. The losses arising from impairment of such investments are recognized as provisions on impairment losses in the consolidated statement of income.

Classified as AFS investments are Petrogen’s investments in government securities (see Note 6).

e. *Derivative Financial Instruments.* The Company uses commodity price swaps to protect its margin on industrial fuel from potential price volatility of crude oil and industrial fuel oil. 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 carried as assets when the fair value is positive and as liabilities when the fair value is negative. The Company has opted not to designate its derivative transactions under hedge accounting. Consequently, gains and losses from changes in fair value of these derivatives are recognized immediately in the consolidated statement of income.

   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. The fair values of commodity swaps are determined based on quotes obtained from counterparty banks.

Accounting Policies Prior to January 1, 2005

a. *Investments in Marketable Equity Securities.* Investments in marketable equity securities, shown under “Short-term investments” account in the 2004 consolidated balance sheet, were stated at the lower of aggregate cost or market value determined as of balance sheet date. The amount by which the aggregate cost exceeds market value was accounted for as a valuation allowance and changes in the valuation allowance are included in the consolidated statement of income. Realized gains or losses from the sales of current marketable equity securities were included in the consolidated statement of income. The cost of marketable equity securities used for determining the gain or loss on the sales of such securities was computed using the average method.

b. *Investments in Shares of Stock.* These investments in proprietary membership shares were carried at cost. An allowance was provided for any substantial and presumably permanent decline in the carrying values of these investments.

c. *Derivative Financial Instruments.* Gains or losses on derivative instruments, including premium amortization, were recognized in current operations simultaneous with the gains or losses on the underlying hedged transactions. No accounting recognition was given to embedded derivatives.

Interest-Bearing Loans and Borrowings
All loans and borrowings are initially recognized at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortized cost using the effective interest method. Amortized cost is calculated by taking into account any related issue costs, discount or premium.

Gains and losses are recognized in the consolidated statement of income when the liabilities are derecognized, as well as through the amortization process.

Impairment of Financial Assets

Effective January 1, 2005

The Company assesses at each balance sheet date whether a financial asset or a group of financial assets is impaired.

Loans and Receivables. If there is objective evidence that an impairment loss on loans and receivables carried at amortized cost has been incurred, the amount of the 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 that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in the consolidated statement of income.

The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed 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 a collective assessment of impairment.

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 the consolidated statement of income, to the extent that the carrying value of the asset does not exceed its amortized cost at the reversal date.

AFS Investments. If an AFS asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortization) and its current fair value, less any impairment loss previously recognized in the consolidated statement of income, is transferred from equity to the consolidated statement of income. Reversals in respect of equity instruments classified as AFS investments are not recognized in the consolidated statement of income. Reversals of impairment losses on debt instruments are reversed through the consolidated statement of income, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognized in the consolidated statement of income.

Derecognition of Financial Assets and Liabilities

Effective January 1, 2005

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 rights to receive cash flows from the asset have expired;
- the Company 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 Company 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.

Where the Company has transferred its rights to receive cash flows from an asset or has entered into a pass-through arrangement, 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 Company’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 original carrying amount of the asset and the maximum amount of consideration that the Company could be required to repay.

Financial Liabilities. A financial liability is derecognized when the obligation under the liability is discharged, cancelled or has expired. Where 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, and the difference in the respective carrying amounts is recognized in the consolidated statement of income.

Offsetting Financial Instruments
Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet 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.

Impact of PAS 32 and PAS 39 Upon Initial Adoption
In 2005, as allowed by the SEC, the adoption of PAS 32 and PAS 39 did not result in the restatement of prior year consolidated financial statements. The cumulative effect of adopting these accounting standards was adjusted to January 1, 2005 equity.

Due to the adoption of PAS 32 and PAS 39, Petrogen classified its investments in government securities as AFS investments. As such, Petrogen recorded these investments at fair value resulting in the recognition of cumulative translation adjustments amounting to ₱2 (net of tax effect of ₱0.7) as of January 1, 2005. Petrogen also changed its method of amortizing bond premiums and discounts from straight-line method to effective interest method resulting in a decrease in retained earnings and investments as of January 1, 2005 by ₱0.4 and ₱0.6, respectively.

Adoption of PAS 39 has increased (decreased) the following accounts in the January 1, 2005 consolidated balance sheet:

	Amount
Receivables	(₱39)
Other current assets	1
Accounts payable and accrued expenses	(10)
Other current liabilities	32
Deferred income tax liabilities	(6)
Other noncurrent liabilities	(6)
Retained earnings	(39)
Minority interest	(9)

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

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

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

For income tax reporting purposes, cost of all inventories is determined using the moving-average method.

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

Interest in a Joint Venture

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

Property, Plant and Equipment

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

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

When each major inspection is performed, its cost is recognized in the carrying amount of the property, plant and equipment as a replacement if the recognition criteria are satisfied.

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

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

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

The useful lives and depreciation and amortization method are reviewed periodically to ensure that the periods and method of depreciation and amortization are consistent with the expected pattern of economic benefits from the items of property, plant and equipment. The residual value, if any, is also reviewed and adjusted if appropriate, at each balance sheet date.

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

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

Investment Properties

Investment properties, except land, are stated at cost less accumulated depreciation and any impairment in value. Cost includes transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met and excludes the costs of day-to-day servicing of an investment property. Land is carried at cost less any impairment in value.

Investment properties are derecognized when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognized in the consolidated statement of income in the year of retirement or disposal.

Transfers are made to investment property when, and only when, there is a change in use, evidenced by the end of owner-occupation, commencement of an operating lease to another party or completion of construction or development. Transfers are made from investment property when, and only when, there is a change in use, evidenced by commencement of owner-occupation or commencement of development with a view to sale. These transfers are recorded using the carrying amount of the investment property at the date of the change in use.

For financial reporting purposes, depreciation on office units is computed on a straight-line basis over the estimated useful lives of the assets of 20 years. For income tax reporting purposes, depreciation is computed using the double-declining balance method.

Impairment of Non-Financial Assets

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

A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the recoverable amount of an asset, however, not to an amount higher than the carrying amount that would have been determined (net of any depreciation and amortization) had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is credited to current operations.

Pension Costs

The Company has a defined benefit pension plan covering all permanent, regular, full-time employees administered by trustee banks. The cost of providing benefits under the defined benefit plans is determined using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognized immediately in full in the consolidated statement of recognized income and expense. Any actuarial gains and losses and adjustments arising from the limits on asset ceiling test are taken directly to retained earnings.

The past service cost is recognized as an expense on a straight-line basis over the average period until the benefits become vested. If the benefits are already vested immediately following the introduction of, or changes to, a pension plan, past service cost is recognized immediately.

The defined benefit liability is the aggregate of the present value of the defined benefit obligation reduced by past service cost not yet recognized and the fair value of plan assets out of which the obligations are to be settled directly. If such aggregate is negative, the asset is measured at the lower of such aggregate or the aggregate of cumulative unrecognized net actuarial losses and past service cost and the present value of any economic benefits available in the form of refunds from the plan or reductions in the future contributions to the plan.

Borrowing Costs

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

Cylinder Deposits

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

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

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

Provisions

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

The Company recognizes provisions arising from legal and/or constructive obligations associated with the cost of dismantling and removing an item of property, plant and equipment and restoring the site where it is located, the obligation for which the Company incurs either when the asset is acquired or as a consequence of having used the asset during a particular year for purposes other than to produce inventories during that year.

Revenue

Revenue is recognized to the extent that it is probable that the economic benefits will flow to the Company and revenue can be reliably measured. The following specific criteria must also be met before revenue is recognized:

Sale of goods. Revenue is recognized when the significant risks and rewards of ownership of the goods have passed to the buyer.

Interest income. Revenue is recognized on a time proportion basis that reflects the effective yield on the assets.

Rental income. Rental income arising on investment properties is accounted for on a straight-line basis over the lease terms.

Dividend income. Dividend income is recognized when the shareholders' right to receive the payment is established.

Operating Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfillment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

a. There is a change in contractual terms, other than a renewal or extension of the arrangement;
b. A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
c. There is a change in the determination of whether fulfillment is dependent on a specified asset; or
d. There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstance gave rise to the reassessment for scenarios a, c or d and at the date of renewal or extension period for scenario b.

For arrangements entered into prior to January 1, 2005, the date of inception is deemed to be January 1, 2005 in accordance with the transitional requirement of Philippine Interpretation IFRIC 4.

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

Company as a Lessor. Leases where the Company retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognized over the lease terms on the same bases as rental income. Operating lease payments are recognized as income in the consolidated statement of income on a straight-line basis over the lease term.

Foreign Currency-Denominated Transactions and Translations
Transactions in foreign currencies are recorded using the exchange rate at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are restated using the spot exchange rate as of balance sheet date. Exchange gains or losses arising from foreign currency-denominated transactions are credited or charged to current operations.

The functional currency of Ovincor, a foreign subsidiary, is the Philippine peso.

Income Taxes

Current Tax. Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date.

Deferred Tax. Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred tax liabilities are recognized for all taxable temporary differences except where the deferred tax liability arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit.

Deferred tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

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

Income tax relating to items recognized directly in equity is recognized in equity and not in the consolidated statement of income.

Deferred income tax is determined using tax rates (and tax laws) that have been enacted or substantially enacted at the balance sheet date and are expected to apply when the related deferred tax asset is realized or the deferred tax liability is settled.

Deferred tax assets and liabilities are offset only if a legally enforceable right exists to offset current tax assets against current tax liabilities and the deferred income taxes relate to the same taxable entity and the same taxation authority.

Sales Tax. Revenues, expenses and assets are recognized net of the amount of sales tax except:

- where the sales tax incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the sales tax is recognized as part of the cost of acquisition of the asset or as part of the expense item as applicable; and

- receivables and payables that are stated with the amount of sales tax included.

The net amount of sales tax recoverable from, or payable to, the taxation authority is included as part of "Receivables" or "Accounts payable and accrued expenses" account in the consolidated balance sheet.

Earnings Per Share Attributable to the Equity Holders of the Parent

Basic earnings per share is computed by dividing net income by the weighted average number of outstanding shares after giving retroactive effect to any stock split and stock dividends declared during the year. The Company has no dilutive potential common shares outstanding that would require disclosure of diluted earnings per share in the consolidated statement of income.

Segments

The Company's operating businesses are recognized and managed separately according to the nature of the products and invoices provided, with each segment representing a strategic business unit that offers different products and serves different markets. Financial information on business and geographical segments are presented in Note 32.

Contingencies

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

Subsequent Events

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

Future Changes in Accounting Policies
The Company has not applied the following PFRS and Philippine Interpretations which are not yet effective for the year ended December 31, 2006:

PFRS 7, “Financial Instruments: Disclosures” and the complementary amendment to PAS 1, “Presentation of Financial Statements,” will be effective for annual periods beginning on or after January 1, 2007. PFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, as well as sensitivity analysis to market risk. It replaces PAS 30, “Disclosures in the Financial Statements of Banks and Similar Financial Institutions,” and the disclosure requirements in PAS 32, “Financial Instruments: Disclosure and Presentation.” It is applicable to all entities that report under PFRS.

The amendment to PAS 1 introduces disclosures about the level of an entity’s capital and how it manages capital. The Company is currently assessing the impact of PFRS 7 and the amendment to PAS 1 and expects that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by PFRS 7 and the amendment to PAS 1. The Company will apply PFRS 7 and the amendment to PAS 1 in 2007.

PFRS 8, “Operating Segments,” will be effective for annual periods beginning on or after January 1, 2009. This PFRS adopts a management approach to reporting segment information. PFRS 8 will replace PAS 14, “Segment Reporting,” and is required to be adopted only by entities whose debt or equity instruments are publicly traded, or are in the process of filing with the SEC for purposes of issuing any class of instruments in a public market. The information reported would be that which management uses internally for evaluating the performance of operating segments and allocating resources to those segments. Such information may be different from that reported in the consolidated balance sheet and consolidated statement of income and companies will need to provide explanations and reconciliations of the differences. The Company will assess the impact of the standard on its current manner of reporting segment information. The Company will apply PFRS 8 in 2009.

Philippine Interpretation IFRIC 7, “Applying the Restatement Approach under PAS 29, Financial Reporting in Hyperinflationary Economies,” will be effective for annual periods beginning on or after March 1, 2006. This interpretation provides guidance on how to apply PAS 29 when an economy first becomes hyperinflationary, in particular, the accounting for deferred income tax. This interpretation has no impact on the consolidated financial statements of the Company. The Company will apply IFRIC 7 in 2007.

Philippine Interpretation IFRIC 11, “PFRS 2 - Group and Treasury Share Transactions,” will be effective for annual periods beginning on or after March 1, 2007. This interpretation requires arrangements whereby an employee is granted rights to an entity’s equity instruments to be accounted for as an equity-settled scheme by the entity even if (a) the entity chooses or is required to buy those equity instruments (e.g., treasury shares) from another party or (b) the shareholder(s) of the entity provide the equity instruments needed. It also provides guidance on how subsidiaries, in their separate financial statements, account for such schemes when their employees receive rights to the equity instruments of the parent company. The Company currently does not have any stock option plan and therefore, does not expect this interpretation to have significant impact on the consolidated financial statements. The Company will apply IFRIC 11 in 2008.

Philippine Interpretation IFRIC 12, "Service Concession Arrangements," will become effective January 1, 2008. This interpretation which covers contractual arrangements arising from entities providing public services, is not relevant to the Company's current operations.

3. Significant Accounting Judgments, Estimates and Assumptions

The preparation of the consolidated financial statements in accordance with PFRS requires the Company to make estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses and disclosure of contingent assets and contingent liabilities. Future events may occur which will cause the assumptions used in arriving at the estimates to change. The effects of any change in estimates are reflected in the consolidated financial statements as they become reasonably determinable.

Judgments and estimates are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

Judgments

In the process of applying the Company's accounting policies, management has made the following judgments, apart from those involving estimations, which have the most significant effect on the amounts recognized in the consolidated financial statements:

Operating Lease Commitments - Company as Lessor/Lessee. The Company has entered into commercial property leases on its investment property portfolio. The Company has determined that it retains all the significant risks and rewards of ownership of the properties leased out on operating leases while the significant risks and rewards for properties leased from third parties are retained by the lessors. Total rent income amounted to ₱345, ₱280 and ₱274 in 2006, 2005 and 2004, respectively (see Note 21), while rent expense amounted to ₱381, ₱306 and ₱271 in 2006, 2005 and 2004, respectively (see Note 18).

Fair Value of Financial Instruments. Where the fair values of financial assets and liabilities recorded in the consolidated balance sheet cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of liquidity and model inputs such as correlation and volatility for longer dated financial instruments.

The aggregate fair value of the financial assets at FVPL and AFS investments amounted to ₱812 and ₱702 as of December 31, 2006 and 2005, respectively (see Notes 5 and 6).

Estimations and Assumptions

The key assumptions concerning the future and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing material adjustments to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Allowance for Doubtful Accounts. Allowance for doubtful accounts is maintained at a level considered adequate to provide for potentially uncollectible receivables. The level of allowance is based on past collection experience and other factors that may affect collectibility. An evaluation of the receivables, designed to identify potential charges to the allowance, is performed regularly throughout the year. Specifically, in coordination with Marketing Group, Credit Management evaluates customers who are unable to meet their financial obligations. In these cases, management uses sound judgment based on the best available facts and circumstances, including but not limited to, the length of relationship with the customers and their payment track record. The amounts of provisions differ for each year based on available objective evidence for which the Company may consider that it will probably not be able to collect some of its accounts. Bad debts are written off when identified to be worthless after exhausting all efforts to collect.

An increase in allowance for doubtful accounts would increase the Company's recorded selling and administrative expenses and decrease current assets. Provisions for doubtful accounts/accounts receivable written off amounted to ₱3, ₱106 and ₱162 in 2006, 2005 and 2004, respectively (see Note 18). Reversal of allowance for doubtful accounts amounted to ₱166 in 2006 (see Note 21). Receivables, net of allowance for doubtful accounts, amounted to ₱15,629 and ₱11,863 as of December 31, 2006 and 2005, respectively (see Note 7).

Allowance for Inventory Obsolescence. The allowance for inventory obsolescence consists of collective and specific provisions. A collective provision is established as a certain percentage based on the age and movement of stocks. In case there is write-off or disposal of slow-moving items during the year, a reduction in the allowance for inventory obsolescence is made.

Review of allowance is done every quarter, while a revised set-up or booking is posted at the end of the year based on evaluations or recommendations of the proponents. The amount and timing of recorded expenses for any year would therefore differ based on the judgments or estimates made.

Reversal of allowance for inventory obsolescence amounted to ₱93 in 2006 (see Note 8). Inventories, net of allowance for obsolescence, amounted to ₱26,289 and ₱27,018 as of December 31, 2006 and 2005, respectively (see Note 8).

Useful Lives. The useful life of each of the Company's item of property, plant and equipment and investment properties is estimated based on the period over which the asset is expected to be available for use. Such estimation is based on a collective assessment of practices of similar businesses, internal technical evaluation and experience with similar assets. The estimated useful life of each asset is reviewed periodically and updated if expectations differ from previous estimates due to physical wear and tear, technical or commercial obsolescence and legal or other limits on the use of the asset. It is possible, however, that future results of operations could be materially affected by changes in the amounts and timing of recorded expenses brought about by changes in the factors mentioned above. A reduction in the estimated useful life of any item of property, plant and equipment and investment properties would increase the recorded cost of goods sold, selling and administrative expenses and decrease noncurrent assets.

There is no change in estimated useful lives of property, plant and equipment and investment properties during the year. Property, plant and equipment and investment properties, net of accumulated depreciation and amortization as of December 31, 2006 and 2005, amounted to ₱25,375 and ₱22,805, respectively (see Notes 9 and 10).

Impairment of Property, Plant and Equipment and Investment Properties. The Company assesses impairment on assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The factors that the Company considers important which could trigger an impairment review include the following:

- significant underperformance relative to expected historical or projected future operating results;
- significant changes in the manner of use of the acquired assets or the strategy for overall business; and
- significant negative industry or economic trends.

The Company recognizes an impairment loss whenever the carrying amount of an asset exceeds its recoverable value. The recoverable amount is computed using the value in use approach. Recoverable amounts are estimated for individual assets or, if it is not possible, for the cash-generating unit to which the asset belongs. Determining the recoverable value of assets requires the estimation of cash flows expected to be generated from the continued use and ultimate disposition of such assets. While it is believed that the assumptions used in the estimation of fair values reflected in the consolidated financial statements are appropriate and reasonable, significant changes in these assumptions may materially affect the assessment of recoverable values and any resulting impairment loss could have a material adverse impact on the results of operations.

No impairment loss was recognized in 2006, 2005 and 2004. The aggregate carrying amount of property, plant and equipment and investment properties, net of accumulated depreciation and amortization amounted to ₱25,375 and ₱22,805 as of December 31, 2006 and 2005, respectively (see Notes 9 and 10).

Pension Costs. The determination of the obligation and cost for pension and other retirement benefits is dependent on the selection of certain assumptions used by actuary in calculating such amounts. Those assumptions are described in Note 25 and include, among others, discount rate and rate of compensation increase. In accordance with PAS 19, "Employee Benefits," as amended, the Company recognizes all actuarial gains and losses in the consolidated statement of recognized income and expense, and therefore generally affects the recorded obligation. While it is believed that the Company's assumptions are reasonable and appropriate, significant differences in actual experience or significant changes in assumptions may materially affect the Company's pension obligations.

Net pension plan assets amounted to ₱434 and ₱1,137 as of December 31, 2006 and 2005, respectively (see Notes 11 and 25). Included under "Other reserves" account in the consolidated balance sheet are cumulative actuarial losses amounting to ₱510 as of December 31, 2006 and cumulative actuarial gains amounting to ₱123 as of December 31, 2005.

Deferred Tax Assets. Significant judgment is required in determining provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The Company recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the current income tax and deferred tax provisions in the year in which such determination is made.

Deferred income tax assets as of December 31, 2006 and 2005 amounted to ₱825 and ₱1,080, respectively (see Note 22).

Asset Retirement Obligation. Determining asset retirement obligation requires estimation of the costs of dismantling, installations and restoring leased properties to their original condition. The Company determined the amount of asset retirement obligation by obtaining estimates of dismantling costs from proponent who is responsible for the operation of the asset discounted at the Company’s current borrowing rates ranging from 7.25% to 9.38% depending on the life of the capitalized costs. While it is believed that the assumptions used in the estimation of such costs are reasonable, significant changes in these assumptions may materially affect the recorded expense or obligation in future periods.

The Company has asset retirement obligation arising from its refinery. Such obligation is not expected to be settled for the foreseeable future and therefore a reasonable estimate of fair value cannot be determined.

Asset retirement obligation as of December 31, 2006 and 2005 amounted to ₱660 and ₱298, respectively (see Note 15).

Contingencies. The Company currently has various tax assessments and legal claims. The Company develops estimate of the probable costs for the assessments and resolution of these claims in consultation with in-house as well as outside legal counsel handling the prosecution and defense of these cases and is based upon an analysis of potential results. The Company currently does not believe these tax assessments and legal claims will have a material adverse effect on its consolidated financial position and results of operations. It is possible, however, that future results of operations could be materially affected by changes in the estimates or in the effectiveness of strategies relating to these proceedings (see Note 33). No provision for probable losses arising from contingencies was recognized in 2006, 2005 and 2004.

4. Cash and Cash Equivalents

	2006	2005
Cash on hand and in banks	**₱3,767**	₱3,445
Money market placements	**7,968**	495
	₱11,735	₱3,940

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

5. Financial Assets at FVPL

	2006	2005
Marketable equity securities	**₱131**	₱82
Proprietary membership shares	**49**	34
	₱180	₱116

Changes in fair value recognized in 2006 and 2005 amounted to ₱63 and ₱14, respectively (see Note 21).

6. AFS Investments

This account consists of investments in government securities of Petrogen which are deposited with the Insurance Commission in accordance with the provisions of the Insurance Code, for the benefit and security of policyholders and creditors of Petrogen. These investments bear fixed interest rates ranging from 8.5% to 14.6% in 2006 and 4.5% to 11.8% in 2005.

Following is the breakdown of investments in government securities by contractual maturity dates as of December 31, 2006 and 2005:

	2006	2005
Due in one year or less	**₱103**	₱259
Due after one year through five years	**529**	327
	₱632	₱586

7. Receivables

	2006	2005
Trade	**₱11,489**	₱11,890
Others	**4,824**	820
	16,313	12,710
Less allowance for doubtful accounts	**684**	847
	₱15,629	₱11,863

Trade receivables are noninterest-bearing and generally on a 45-day term.

8. Inventories

	2006	2005
At cost:		
Petroleum	**₱13,867**	₱14,683
Crude oil and others	**11,905**	11,947
At net realizable value -		
TBA products, materials and supplies	**517**	388
	₱26,289	₱27,018

Using the moving-average method, the cost of petroleum, crude oil and other products would have increased by ₱355 as of December 31, 2006 and ₱619 as of December 31, 2005.

Cost of TBA products, material and supplies amounted to ₱858 as of December 31, 2006 and ₱822 as of December 31, 2005. Reversal of allowance for inventory obsolescence charged to cost of goods sold amounted to ₱93 in 2006 (see Note 17).

Inventories charged to cost of goods sold amounted to ₱194,281, ₱173,789 and ₱132,811 in 2006, 2005 and 2004, respectively (see Note 17).

9. Property, Plant and Equipment

	2006						
	Buildings and Related Facilities	**Refinery and Plant Equipment**	**Service Stations and Other Equipment**	**Computers, Office and Motor Equipment**	**Land and Leasehold Improvements**	**Construction in-Progress**	**Total**
Net carrying amount, at January 1, 2006	**₱5,585**	**₱11,569**	**₱707**	**₱445**	**₱2,722**	**₱1,542**	**₱22,570**
Additions	**47**	**–**	**18**	**10**	**15**	**4,962**	**5,052**
Reclassifications	**1,339**	**(1,339)**	**–**	**–**	**–**	**–**	**–**
Depreciation and amortization for the year (see Note 20)	**(599)**	**(1,369)**	**(214)**	**(178)**	**(109)**	**–**	**(2,469)**
Transfers	**840**	**348**	**327**	**226**	**193**	**(1,934)**	**–**
Net carrying amount, at December 31, 2006	**₱7,212**	**₱9,209**	**₱838**	**₱503**	**₱2,821**	**₱4,570**	**₱25,153**

	2006						
	Buildings and Related Facilities	**Refinery and Plant Equipment**	**Service Stations and Other Equipment**	**Computers, Office and Motor Equipment**	**Land and Leasehold Improvements**	**Construction in-Progress**	**Total**
At December 31, 2006							
Cost	**₱13,041**	**₱18,361**	**₱3,390**	**₱2,010**	**₱3,874**	**₱4,570**	**₱45,246**
Accumulated depreciation and amortization	**(5,829)**	**(9,152)**	**(2,552)**	**(1,507)**	**(1,053)**	**–**	**(20,093)**
Net carrying amount	**₱7,212**	**₱9,209**	**₱838**	**₱503**	**₱2,821**	**₱4,570**	**₱25,153**

	2005						
	Buildings and Related Facilities	Refinery and Plant Equipment	Service Stations and Other Equipment	Computers, Office and Motor Equipment	Land and Leasehold Improvements	Construction in-Progress	Total
Net carrying amount, at January 1, 2005	₱5,510	₱9,358	₱540	₱433	₱917	₱5,688	₱22,446
Additions	195	–	16	8	1,861	368	2,448
Depreciation and amortization for the year (see Note 20)	(408)	(1,476)	(177)	(146)	(117)	–	(2,324)
Transfers	288	3,687	328	150	61	(4,514)	–
Net carrying amount, at December 31, 2005	₱5,585	₱11,569	₱707	₱445	₱2,722	₱1,542	₱22,570
At December 31, 2005							
Cost	₱8,081	₱22,105	₱3,037	₱1,796	₱3,667	₱1,542	₱40,228
Accumulated depreciation and amortization	(2,496)	(10,536)	(2,330)	(1,351)	(945)	–	(17,658)
Net carrying amount	₱5,585	₱11,569	₱707	₱445	₱2,722	₱1,542	₱22,570

Interest capitalized in 2006 amounted to ₱52 using capitalization rates of 6.843% and 8.705% for general and specific borrowing peso loans, respectively. Interest capitalized in 2005 amounted to ₱46 using a capitalization rate of 6.94% for general borrowing peso loans.

10. **Investment Properties**

	2006		
	Land	**Office Units**	**Total**
Net carrying amount, at January 1, 2006	**₱48**	**₱187**	**₱235**
Depreciation for the year (see Note 20)	**–**	**(13)**	**(13)**
Net carrying amount, at December 31, 2006	**₱48**	**₱174**	**₱222**
At December 31, 2006			
Cost	**₱48**	**₱263**	**₱311**
Accumulated depreciation	**–**	**(89)**	**(89)**
Net carrying amount	**₱48**	**₱174**	**₱222**

	2005		
	Land	Office Units	Total
Net carrying amount, at January 1, 2005	₱32	₱198	₱230
Additions	16	–	16
Depreciation for the year (see Note 20)	–	(11)	(11)
Net carrying amount, at December 31, 2005	₱48	₱187	₱235
At December 31, 2005			
Cost	₱48	₱263	₱311
Accumulated depreciation	–	(76)	(76)
Net carrying amount	₱48	₱187	₱235

The Company’s investment properties consist of office units located in Petron MegaPlaza and parcels of land in various locations intended for service stations. Estimated fair values for office units located in Petron MegaPlaza based on zonal valuation determined by the Bureau of Internal Revenue (BIR), amounted to ₱183 in 2006.

Rental income earned from the investment properties amounted to ₱16, ₱20 and ₱15 in 2006, 2005 and 2004, respectively.

There are no other direct selling and administration expenses (i.e., repairs and maintenance) arising from investment properties that generated rent income in 2006, 2005 and 2004.

11. **Other Noncurrent Assets**

	2006	2005
Net pension plan assets (see Note 25)	**₱434**	₱1,137
Others	**188**	124
	₱622	₱1,261

12. Short-term Loans

This account pertains to unsecured peso loans obtained from local banks with interest ranging from 5.0% to 7.5%, intended to fund the importation of crude oil and petroleum products, capital expenditures and working capital requirements.

13. Accounts Payable and Accrued Expenses

	2006	2005
Accounts payable	**₱1,298**	₱472
Accrued expenses	**1,390**	1,406
Specific and other taxes payable	**425**	336
Derivative liabilities (see Note 30)	**64**	5
Others	**554**	407
	₱3,731	₱2,626

Terms and conditions are as follows:

- Accounts payable are noninterest-bearing and are normally settled on a 30-day term.
- Accrual of unpaid interest and selling and administrative expenses are normally settled within a year.

14. Long-term Debt

	2006	2005
Unsecured peso loans (net of debt issue cost amounting to ₱70 in 2006)	**₱8,538**	₱1,673
Syndicated dollar bank loans (net of debt issue costs amounting to ₱58 in 2006 and ₱80 in 2005)	**4,374**	5,258
	12,912	6,931
Less current portion (net of debt issue costs amounting to ₱41 in 2006 and ₱21 in 2005)	**1,633**	1,906
	₱11,279	₱5,025

Movements of debt issue costs are as follows:

	2006	2005
Beginning balance	**₱80**	₱100
Additions	**74**	–
Accretion for the year (see Note 21)	**(26)**	(20)
Ending balance	**₱128**	₱80

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

Original Amount	Land Bank - ₱2 billion	BPI - ING ₱6.3 billion	NORD - LB US$100 million	Citibank - ₱2 billion
Payment Terms	12 equal quarterly installments starting March 2009 up to November 2011	One time payment in August 2011	Six semi-annual installments starting on the 30th month from June 2004 up to June 2009	13 equal quarterly installments starting April 2004 up to April 2007
Interest (2006)	6.1%	8.875%	5.7% to 6.8%	6.7% to 8.2%
Security	None	None	None	None
Major Covenants	None	Maintenance of certain financial ratios	Maintenance of certain financial ratios	Maintenance of certain financial ratios

As of December 31, 2006, the Company is in compliance with its loan covenants. Loan maturities (gross of ₱128 debt issue costs) for the next five years are as follows:

Year	Amount
2007	₱1,674
2008	1,962
2009	1,770
2010	667
2011	6,967
	₱13,040

15. **Other Noncurrent Liabilities**

	2006	2005
Asset retirement obligation (ARO)	**₱660**	₱298
Cylinder deposits	**206**	244
Cash bonds	**141**	119
Others	**42**	36
	₱1,049	₱697

Movements of ARO are as follows:

	2006	2005
Beginning balance	**₱298**	₱256
Additions	**10**	9
Effect of change in discount rate	**324**	–
Accretion for the year (see Note 21)	**37**	33
Settlement	**(9)**	–
Ending balance	**₱660**	₱298

The Company has ARO arising from its refinery. Such obligation is not expected to be settled for the foreseeable future and therefore a reasonable estimate of fair value cannot be determined.

16. **Changes in Equity**

	Equity Attributable to Holders of the Parent			
		Retained Earnings		Minority
	Capital Stock	Appropriated	Unappropriated	Interest
Balance at January 1, 2006	**₱9,375**	**₱11,652**	**₱6,352**	**₱108**
Net income for the year	**–**	**–**	**6,011**	**7**
Actuarial gains due to limit on recognized plan asset - net of tax effect	**–**	**–**	**176**	**–**
Appropriation for capital projects	**–**	**5,369**	**(5,369)**	**–**
Cash dividends - ₱0.10 per share	**–**	**–**	**(938)**	**–**
Balance at December 31, 2006	**₱9,375**	**₱17,021**	**₱6,232**	**₱115**
Balance at December 31, 2004, as restated	₱9,375	₱6,906	₱5,623	₱110
Effect of changes in accounting for financial instruments (see Note 2)	–	–	(39)	(9)
Balance at January 1, 2005, as adjusted	9,375	6,906	5,584	101
Net income for the year	–	–	6,044	7
Actuarial gains due to limit on recognized plan asset - net of tax effect	–	–	408	–
Appropriation for capital projects	–	4,746	(4,746)	–
Cash dividends - ₱0.10 per share	–	–	(938)	–
Balance at December 31, 2005	₱9,375	₱11,652	₱6,352	₱108
Balance at January 1, 2004	₱9,375	₱5,551	₱4,874	₱103
Net income for the year	–	–	4,094	7
Actuarial losses due to limit on recognized plan asset - net of tax effect	–	–	(115)	–
Appropriation for capital projects	–	1,355	(1,355)	–
Cash dividends - ₱0.20 per share	–	–	(1,875)	–
Balance at December 31, 2004	₱9,375	₱6,906	₱5,623	₱110

a. Capital Stock

	Number of Shares	Amount
Authorized - ₱1.00 par value	10,000,000,000	₱10,000
Issued and outstanding	9,375,104,497	₱9,375

Petron was registered with the SEC on December 15, 1966.

The issued and outstanding common shares have been adjusted for the fractional shares issued in prior years.

b. Retained Earnings

i. Declaration of Cash Dividends

In 2006 and 2005, the Company declared a cash dividend of ₱0.10 per share amounting to ₱938 to all stockholders of record as of June 2, 2006 and May 12, 2005, respectively. In 2004, a cash dividend of ₱0.20 per share amounting to ₱1,875 was declared to all stockholders of record as of May 19, 2004.

ii. Appropriation for Capital Projects

Petron appropriated ₱5,369 in 2006 and ₱4,746 in 2005 for future capital projects.

17. **Cost of Goods Sold**

	2006	2005	2004
Inventories (see Notes 8, 23 and 26)	**₱194,281**	₱173,789	₱132,811
Depreciation and amortization (see Note 20)	**1,536**	1,459	1,009
Employee costs (see Notes 19 and 25)	**406**	411	378
Others - net (see Note 8)	**1,291**	1,551	1,200
	₱197,514	₱177,210	₱135,398

18. **Selling and Administrative Expenses**

	2006	2005	2004
Employee costs (see Notes 19 and 25)	**₱1,199**	₱1,023	₱1,225
Depreciation and amortization (see Note 20)	**946**	876	847
Purchased services and utilities	**817**	748	734
Maintenance and repairs	**473**	567	629
Rent (see Note 23)	**381**	306	271
Advertising	**222**	398	403
Materials and office supplies	**164**	281	260
Expenses related to oil spill incident in Guimaras (see Note 33f)	**122**	–	–
Taxes and licenses	**104**	102	177
Provision for doubtful accounts/accounts receivable written-off	**3**	106	162
Others	**54**	120	169
	₱4,485	₱4,527	₱4,877

19. Employee Costs

Employee costs consist of:

	2006	2005	2004
Salaries, wages and other employee costs	**₱1,601**	₱1,432	₱1,596
Pension costs (see Note 25)	**4**	2	7
	₱1,605	₱1,434	₱1,603

The above amounts are distributed as follows:

	2006	2005	2004
Cost of goods sold (see Note 17)	**₱406**	₱411	₱378
Selling and administrative expenses (see Note 18)	**1,199**	1,023	1,225
	₱1,605	₱1,434	₱1,603

20. Depreciation and Amortization

Depreciation and amortization are distributed as follows:

	2006	2005	2004
Cost of goods sold -			
Property, plant and equipment (see Notes 9 and 17)	**₱1,536**	₱1,459	₱1,009
Selling and administrative expenses (see Note 18):			
Property, plant and equipment (see Note 9)	**933**	865	835
Investment properties (see Note 10)	**13**	11	12
	946	876	847
	₱2,482	₱2,335	₱1,856

21. Interest Expense, Interest Income and Others

	2006	2005	2004
Interest expense:			
Short-term loans (see Note 12)	**(₱1,608)**	(₱810)	(₱985)
Long-term debt (see Note 14)	**(594)**	(805)	(341)
Accretion on ARO (see Note 15)	**(37)**	(33)	(28)
Product borrowings	**(31)**	(57)	(87)
Accretion on debt issue costs (see Note 14)	**(26)**	(20)	(10)
Others	**(388)**	(366)	(224)
	(₱2,684)	(₱2,091)	(₱1,675)

	2006	2005	2004
Interest income:			
Money market placements	**₱250**	₱249	₱180
Trade receivables	**83**	42	124
Cash in banks	**12**	9	8
Product loaning	**9**	13	28
Investment bonds	**–**	–	2
Others	**8**	4	2
	₱362	₱317	₱344

	2006	2005	2004
Other income (charges):			
Rent	**₱345**	₱280	₱274
Foreign exchange gain (loss) - net	**388**	306	(298)
Derivatives net of fair value loss (see Note 30)	**(279)**	(260)	–
Reversal of allowance for doubtful accounts	**166**	–	–
Changes in fair value of financial assets at FVPL (see Note 5)	**63**	14	(91)
Insurance claims (see Note 23)	**29**	–	–
Gain on settlement of ARO (see Note 15)	**13**	–	–
Miscellaneous	**(226)**	(176)	(280)
	₱499	₱164	(₱395)

22. **Income Taxes**

The major components of provision for (benefit from) income tax are as follows:

	2006	2005	2004
Current income tax -			
Current income tax charge	**₱1,723**	₱2,057	₱1,339
Deferred income tax:			
Relating to origination and reversal of temporary differences	**₱108**	₱102	(₱16)
Change in tax rate	**55**	(68)	–
	₱163	₱34	(₱16)

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

	2006	2005
Deferred tax assets:		
Rental	**₱163**	₱205
Inventory differential	**124**	217
ARO	**81**	90
Various allowances, accruals and others	**456**	565
	824	1,077
Deferred tax liabilities:		
Excess of double-declining over straight-line method of depreciation and amortization	**1,270**	1,267
Capitalized taxes and duties on inventories deducted in advance	**388**	411
Unrealized foreign exchange gain - net	**112**	97
Capitalized interest, duties and taxes on property, plant and equipment deducted in advance and others	**358**	445
	2,128	2,220
	(₱1,304)	(₱1,143)

Net deferred tax assets of the subsidiaries without right of offset amounted to ₱1 and ₱3 as of December 31, 2006 and 2005, respectively.

The components deferred tax liabilities charged to equity are as follows:

	2006	2005
Net pension plan asset	**₱130**	₱372
Unrealized fair value gains on AFS investments	**9**	1
	₱139	₱373

The reconciliation between the provision for income tax computed at the applicable statutory income tax rates and, using tax rates of 35% in 2006 and 32% for the period starting January 1 to October 31 and 35% for the period starting from November 1 to December 31 in 2005 and 32% in 2004, provision for income tax as shown in the consolidated statements of income is summarized as follows:

	2006	2005	2004
Income tax computed at statutory income tax rates	**₱2,766**	₱2,646	₱1,736
Additions (reductions) resulting from:			
Income subject to income tax holiday (see Note 31)	**(736)**	(440)	(410)
Changes in fair value of financial assets at FVPL (see Note 21)	**(22)**	(5)	29
Interest income subjected to lower final tax and others	**(122)**	(110)	(32)
	₱1,886	₱2,091	₱1,323

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

On May 24, 2005, the President of the Republic of the Philippines signed into law Republic Act (RA) No. 9337, which took effect on November 1, 2005, introducing the following changes:

a. Regular corporate income tax (RCIT) rate for domestic corporations and resident and non-resident foreign corporations is increased to 35% (from 32%) beginning November 1, 2005 and the rate will be reduced to 30% beginning January 1, 2009. RCIT rate shall be applied on the amount computed by multiplying the number of months covered by the new rate within the fiscal year by the taxable income of the corporation for the period, divided by 12 months.

b. Power of the President upon the recommendation of the Secretary of Finance to increase the rate of value added tax (VAT) to 12% (from 10%), after any of the following conditions has been satisfied:

   i. VAT collection as a percentage of gross domestic product (GDP) of the previous year exceeds two and four-fifth percent (2 4/5%); or

   ii. National Government deficit as a percentage of GDP of the previous year exceeds one and one-half percent (1 1/2%).

   On January 31, 2006, a Revenue Memorandum Circular No. 7-2006 was issued approving the recommendation of the Secretary of Finance to increase VAT to 12% (from 10%) effective February 1, 2006.

c. Input VAT on completed/finished capital goods should be spread evenly over the useful life or 60 months, whichever is shorter, if the acquisition costs, excluding the VAT component thereof exceed ₱1. On the other hand, input VAT on assembled or constructed capital goods shall be recognized at the time of payment to the independent constructors as it involved a sale of service.

d. Input VAT credit in every quarter shall not exceed 70% of the output VAT if the amount of input VAT exceeds the total output VAT. The excess input VAT shall be carried over to the succeeding period/s and is not allowed to be written-off for income tax purposes.

   However, last November 21, 2006, RA No. 9361 was approved removing the 70% cap on input VAT. This means that VAT-registered taxpayers are allowed to have excess input taxes, and not VAT payable, at the end of any taxable quarter. The excess input VAT shall be carried over to the succeeding quarter or quarters. This new ruling is effective December 13, 2006.

23. **Related Party Transactions**

The significant transactions with related parties are as follows:

			2006	
Name of Company	Relationship	Nature of Transaction	**Transaction Amount**	**Balance at End of Year**
Saudi Arabian Oil Company (Saudi Aramco)	Ultimate parent of Aramco Overseas Company B.V. (Stockholder)	Crude purchases	**₱145,099**	**(₱36)**
Philippine National Oil Company (PNOC)	Stockholder	Leases	**147**	**(33)**

			2005	
Name of Company	Relationship	Nature of Transaction	Transaction Amount	Balance at End of Year
Saudi Aramco	Ultimate parent of Aramco Overseas Company B.V. (Stockholder)	Crude purchases	₱122,826	(₱5,728)
PNOC	Stockholder	Leases	145	–

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

- Petron has long-term lease agreements with PNOC until August 2018 covering certain lots where its refinery and other facilities are located. Lease charges on refinery facilities escalate at 2% a year, subject to increase upon reappraisal (see Note 24).

Total compensation and benefits of key management personnel of the Company, amounting to ₱319, ₱290 and ₱278 in 2006, 2005 and 2004, respectively, consist of:

	2006	2005	2004
Salaries and other short-term employee benefits	**₱277**	₱248	₱232
Post-employment benefits (see Note 25)	**42**	42	46
	₱319	₱290	₱278

24. Operating Lease Commitments

Company as Lessee
The Company entered into commercial leases on certain parcels of land. These leases have an average life of between one to 16 years with renewal options included in the contracts. There are no restrictions placed upon the Company by entering into these leases. The lease agreements include upward escalation adjustment of the annual rental rates.

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

	2006	2005
Within one year	**₱384**	₱377
After one year but not more than five years	**1,728**	1,518
After five years	**1,558**	2,620
	₱3,670	₱4,515

Company as Lessor
The Company has entered into lease agreements on its investment property portfolio, consisting of surplus office spaces and parcels of land. The non-cancellable leases have remaining terms of between three to five years. All leases include a clause to enable upward escalation adjustment of the annual rental rates.

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

	2006	2005
Within one year	**₱177**	₱168
After one year but not more than five years	**202**	175
After five years	**123**	141
	₱502	₱484

25. Pension Plan

The following tables summarize the components of net pension costs recognized in the consolidated statements of income and the funded status and amounts recognized in the consolidated balance sheets for the pension plan.

Net Pension Costs (Recognized in Selling and Administrative Expenses)

	2006	2005	2004
Current service cost	**₱122**	₱101	₱106
Interest cost on benefit obligation	**256**	239	206
Expected return on plan assets	**(374)**	(338)	(305)
Net pension costs	**₱4**	₱2	₱7
Actual return on plan assets	**₱687**	₱437	₱395

Actuarial Gain (Loss) Recognized Directly in Equity

	2006	2005	2004
Actuarial gain (loss) for the year due to present value of obligation	**(₱1,282)**	(₱363)	₱364
Actuarial gain for the year	**313**	99	90
Actuarial gain (loss) due to limit on recognized plan assets	**270**	620	(168)
Net actuarial gain (loss) recognized	**(₱699)**	₱356	₱286

Net Pension Asset

	2006	2005
Defined benefit obligation	**₱3,783**	₱2,330
Fair value of plan assets	**4,217**	3,737
Pension asset	**434**	1,407
Less unrecognized assets due to limit	–	270
Net pension asset recognized (see Note 11)	**₱434**	₱1,137

Changes in the present value of the defined benefit obligation are as follows:

	2006	2005
Opening defined benefit obligation	**₱2,330**	₱1,709
Interest cost	**256**	239
Current service cost	**122**	101
Benefits paid	**(207)**	(82)
Actuarial loss on obligation	**1,282**	363
Closing defined benefit obligation	**₱3,783**	₱2,330

Changes in the fair value of plan assets are as follows:

	2006	2005
Opening fair value of plan assets	**₱3,737**	₱3,382
Expected return	**374**	338
Benefits paid	**(207)**	(82)
Actuarial gains on plan assets	**313**	99
Closing fair value of plan assets	**₱4,217**	₱3,737

The Company does not expect to contribute to its defined benefit pension plan until 2010.

The major categories of plan assets as a percentage of the fair value of total plan assets are as follows:

	2006	2005
Cash	**1%**	5%
Government securities	**57%**	71%
Stocks	**31%**	15%
Real estate	**7%**	8%
Others	**4%**	1%
	100%	100%

The overall expected rate of return on assets is determined based on the market prices prevailing on that date, applicable to the period over which the obligation is to be settled. There has been a significant change in the expected rate of return on assets due to the improved stock market scenario.

As of January 1, 2006 and 2005, the principal assumptions used in determining obligations for the Company's pension plan are shown below:

	2006	2005
Discount rate	**11%**	14%
Expected rate of return on plan assets	**10%**	10%
Future salary increases	**8.5%**	9%

The prevailing discount rate as of December 31, 2006 is 7.25%.

Amounts for the current and previous four periods are as follows:

	2006	2005	2004	2003	2002
Defined benefit obligation	**₱3,783**	₱2,330	₱1,709	₱1,821	₱2,073
Fair value of plan assets	**4,217**	3,737	3,382	3,047	2,841
Surplus	**₱434**	₱1,407	₱1,673	₱1,226	₱768

Experience adjustments on present value of obligation amounted to ₱151 in 2006.

26. Supplementary Information

a. Processing License Agreement

Petron has an agreement with Pennzoil-Quaker State International Corporation (Pennzoil) for the exclusive right to manufacture, sell and distribute in the Philippines certain Pennzoil products until December 31, 2008. The agreement also includes the license to use certain Pennzoil trademarks in exchange for the payment of royalty fee based on net sales value. Royalty expense amounting to ₱0.9, ₱1.07 and ₱1.20 in 2006, 2005 and 2004, respectively, are included as part of "Cost of goods sold" account in the consolidated statements of income.

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

The Company entered into various fuel supply contracts with NPC. Under the agreement, the Company supplies the bunker fuel and diesel fuel oil requirements to selected NPC plants and NPC-supplied Independent Power Plants.

In the bidding held last November 9, 2006, for NPC fuel requirements from January to December 2007, Petron won a total of 13,604 kilo-liters (KL) of diesel fuel and 308,584 KL of bunker fuel worth ₱2,390 and ₱6,967, respectively.

Sales from the above transactions amounted to ₱10,727, ₱10,211 and ₱11,453 in 2006, 2005 and 2004, respectively.

27. Basic Earnings Per Share Attributable to Equity Holders of the Parent

	2006	2005	2004
Net income attributable to equity holders of the parent	**₱6,011**	₱6,044	₱4,094
Weighted average number of shares	**9,375,104,497**	9,375,104,497	9,375,104,497
Basic earnings per share	**₱0.64**	₱0.64	₱0.44

28. Supplemental Disclosure of Cash Flow Information

Changes in operating assets and liabilities:

	2006	2005	2004
Decrease (increase) in assets:			
Trade receivables	**₱337**	(₱2,084)	(₱2,503)
Inventories	**822**	(4,769)	(4,316)
Other current assets	**(5,842)**	(1,796)	(69)
Increase (decrease) in liabilities:			
Liabilities for crude oil and petroleum product importation	**(289)**	1,814	(445)
Accounts payable and accrued expenses	**859**	158	706
	(4,113)	(6,677)	(6,627)
Provisions (reversal of allowance) for doubtful accounts, inventory obsolescence and others	**(169)**	351	534
	(₱4,282)	(₱6,326)	(₱6,093)

29. Financial Risk Management Objectives and Policies

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

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

The main risks arising from the Company'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, as summarized below:

Foreign Exchange Risk

Foreign exchange risk occurs due to currency differences in the Company's assets and liabilities. The Company's foreign currency-denominated assets and liabilities were predominantly in U.S. dollars in 2006 and 2005.

This is a major structural risk for the Company since crude and product imports, which comprise the bulk of its inputs to operations, are U.S. dollar-denominated. On the other hand, the Company receives peso-denominated revenue for the majority of its product sales.

The Company pursues a policy of hedging foreign exchange risk by purchasing currency forwards or by substituting U.S. dollar-denominated liabilities with peso-based debt. The natural hedge provided by 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 Company 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.

Interest Rate Risk

The Company's exposure to interest rate risk is mainly related to its long-term debt instruments. Currently, the Company has achieved a balanced mix of fixed and floating rates on its various long-term debts.

Future hedging decisions for floating interest rates will continue to be guided by an assessment of the overall interest rate risk profile of the Company's consolidated balance sheet and the net effect on this of possible interest rate movements.

Credit Risk
In effectively managing credit risk, Petron regulates and extends credit only to qualified and credit-worthy customers in consonance with established Company credit policies and guidelines and credit verification procedures. Requests for credit lines from trade customers undergo stages of review between the Marketing and Finance Groups while approvals, which are based on amounts of credit lines requested, are vested among line managers and top management that include the President and the Chairman. To the extent practicable, Petron also requires collateral as security for a credit facility to mitigate risk of customer's default.

In monitoring trade receivables and credit lines, Petron 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. In close coordination with Petron's Marketing Group which is primarily tasked with collecting customers' accounts through the account executives scattered nationwide, Credit Department regularly reports to management trade receivable balances (monthly) and credit utilization (semi-annual) efficiency. The Company has made provisions, where necessary, for potential losses on credits extended.

The Company's exposure to credit risk arises from default of the counterparty with a maximum exposure equal to the carrying amount of these instruments, net of the value of collaterals, if any.

Counterparties to financial instruments consist of a large number of prime financial institutions. The Company does not expect any counterparty to default in its obligations, given the high credit ratings. The Company has no significant concentration of credit risk with any counterparty.

Liquidity Risk
The Company is exposed to the possibility that adverse changes in the business environment and/or its operations would result to substantially higher working capital requirements and the subsequent difficulty in financing additional working capital.

The Company manages liquidity risk by maintaining a pool of credit lines from financial institutions that exceeds expected financing requirements for working capital. The Company likewise regularly evaluates other financing instruments and arrangements to broaden the Company's range of financing sources.

Commodity Price Risk
To minimize the Company's risk of potential losses due to volatility of Dubai and Singapore's Mean of Platts (MOPS) prices, the Company implemented commodity hedging for hedgeable petroleum products. Hedging policy (including the use of commodity price swaps) developed by the Risk Management Committee is already in place. Decisions are guided by the conditions set and approved by the Company's management.

30. **Financial Instruments**

Derivative Instruments
The Parent Company's derivative transactions are intended as economic hedge of well-defined foreign currency and commodity price risks. The Parent Company opted to adopt non-hedge accounting treatment for all its derivative transactions (including embedded derivatives).

Freestanding Derivatives. The Parent Company uses IFO-Dubai crack spread swaps to protect its margin on export and domestic sales of industrial fuel oil products. The cost base of the Parent Company's industrial fuel is that of the crude oil, most of which is supplied by Saudi Aramco and is priced based on Dubai/Oman crude price. On the other hand, the selling price of the industrial fuel is based on MOPS. Under the crack spread swap, the Parent Company and its counterparties agree to a monthly exchange of cash settlements based on a specified reference price, depending on the commodity being hedged. For the IFO portion of the crack spread swap that hedges the price risks on industrial fuel oil products, the Company acts as the floating rate payer and the reference price index is the monthly MOPS for HSFO 180 CST. For the Dubai portion that hedges the price risks on crude oil, the Parent Company acts as the fixed rate payer and the reference price index is the monthly average for Platt's Dubai Crude. The swap agreements effectively hedge the Parent Company's margin on industrial fuel oil. As of December 31, 2006 and 2005, there are no outstanding commodity swaps.

On January 22, 2007, Petron concluded with Mitsui & Co. Energy Risk Management a Fuel Oil / Dubai crack swap for February 2007 for a volume of 10,000 barrels. Approved monthly allowable volume to be hedged ranges from 250,000-500,000 barrels, depending on export volumes contracted for a given month.

The Parent Company also enters into deliverable and non-deliverable short-term currency forward contracts to hedge its foreign currency exposure on crude oil importations. As of December 31, 2006 and 2005, the Parent Company has outstanding currency forward contracts with an aggregate notional amount of US$109 and US$45, respectively, and weighted average contracted forward rate of ₱49.704 to US$1.00 and ₱53.206 to US$1.00, respectively. The net fair value loss on these currency forward contracts as of December 31, 2006 and 2005 amounted to ₱64 and ₱5, respectively.

Embedded Derivatives. Embedded foreign currency derivatives exist in certain of the Parent Company's U.S. dollar-denominated sales and purchase contracts for various fuel products. Under the sales contracts, the Parent Company agrees to fix the peso equivalent of the invoice amount based on the average Philippine Dealing System (PDS) rate of the month of delivery. In the purchase contracts, the peso equivalent is determined using the average PDS rate of the month preceding the month of delivery. The net fair value gain on these transactions as of December 31, 2006 and 2005 amounted to ₱58 and ₱60, respectively.

Fair Value Changes on Derivatives

The net movements in fair value changes of all derivative transactions in 2006 and 2005 are as follows:

	MTM Loss
Fair values at January 1, 2006	**(₱55)**
Net changes in fair value during the year (see Note 21)	**279**
Less fair value of settled instruments	**218**
Balance at December 31, 2006	**₱6**
Fair values at January 1, 2005	₱31
Net changes in fair value during the year (see Note 21)	260
Less fair value of settled instruments	346
Balance at December 31, 2005	(₱55)

Included in the consolidated balance sheets as follows:

	2006	2005
Derivative assets (included under "Other current assets" account)	**₱58**	₱60
Derivative liabilities (see Note 13)	**(64)**	(5)
Net	**(₱6)**	₱55

Interest Rate Risk

The following table sets out the carrying amount, by maturity, of the Company's financial instruments that are exposed to interest rate risk:

	Interest Rates	Within 1 Year	1-2 years	2-3 Years	3-4 years	4-5 Years	Total
2006 Fixed Rate:							
Short-term debt (PHP)	**5.3%**	**₱28,115**	**–**	**–**	**–**	**–**	**₱28,115**
Long-term debt - (FXCN in PHP)	**8.875%**	**–**	**–**	**–**	**–**	**₱6,300**	**₱6,300**
2006 Floating Rate:							
Long-term loan (Landbank)	**6.1%**	**–**	**–**	**₱667**	**₱667**	**₱666**	**₱2,000**
Long-term loan (Citibank)	**7.4%**	**₱308**	**–**	**–**	**–**	**–**	**₱308**
Long-term loan (NORD in USD)	**6.2%**	**$28**	**$40**	**$22**	**–**	**–**	**$90**
2005 Fixed Rate - Short-term debt (PHP)	7.0%	₱21,432	–	–	–	–	₱21,432
2005 Floating Rate:							
Long-term loan (Landbank)	7.2%	750	–	–	–	–	750
Long-term loan (Citibank)	8.0%	₱615	₱308	–	–	–	₱923
Long-term loan (NORD in USD)	5.8%	$10	$28	–	$62	–	$100

Interest on financial instruments classified as floating rate was repriced quarterly for the peso loans and quarterly or semi-annually for the U.S. dollar-denominated loans. Interest on financial instruments classified as fixed rate was fixed until the maturity of the instrument. Other financial liabilities of the Company that were not included in the above tables were noninterest-bearing and were, therefore, not subject to interest rate risk.

The Company has interest-bearing assets of ₱12,367 as of December 31, 2006 and ₱4,526 as of December 31, 2005, of which ₱11,598 and ₱4,330, respectively, have maturities within 1 year (see Notes 4 and 6). Financial assets at FVPL are noninterest-bearing investments and are therefore not subject to interest rate volatility (see Note 5).

The following table sets forth the carrying values and estimated fair values of the Company's financial assets and liabilities:

	2006		2005	
	Carrying Value	**Fair Value**	Carrying Value	Fair Value
Current financial assets:				
Cash and cash equivalents	**₱11,735**	**₱11,735**	₱3,940	₱3,940
Financial assets at FVPL	**180**	**180**	116	116
AFS investments	**103**	**103**	259	259
Receivables	**15,629**	**15,629**	11,863	11,863
Derivative assets (included under "Other current assets" account)	**58**	**58**	60	60
Total current financial assets	**27,705**	**27,705**	16,238	16,238
Noncurrent financial assets - AFS investments	**529**	**529**	327	327
Total financial assets	**₱28,234**	**₱28,234**	₱16,565	₱16,565
Current financial liabilities:				
Short-term loans	**₱28,135**	**₱28,135**	₱21,407	₱21,407
Liabilities for crude oil and petroleum product importation	**7,541**	**7,541**	7,911	7,911
Accounts payable and accrued expenses	**2,752**	**2,752**	1,883	1,883
Total current financial liabilities	**38,428**	**38,428**	31,201	31,201
Noncurrent financial liabilities:				
Cash bonds (included under "Other noncurrent liabilities" account)	**141**	**135**	119	98
Long-term debt (including current portion)	**12,912**	**12,973**	6,931	7,032
Total financial liabilities	**₱51,481**	**₱51,536**	₱38,251	₱38,331

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for financial assets and which it is practicable to estimate such value:

Financial Assets at FVPL and AFS Investments. Market values have been used to determine the fair values of traded government securities and equity shares.

*Derivative Assets and Liabilitie*s. 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.

Cash Bonds. Fair value is estimated as the present value of all future cash flows discounted using the applicable rates for similar types of instruments. Discount rates used in 2006 and 2005 are 5.690% and 9.968%, respectively.

Long-term Debt - Floating Rate. For variable rate loans that reprice every three months, the carrying value approximates the fair value because of recent and regular repricing based on current market rates. For variable rate loans that reprice every six months, the fair value is determined by discounting the principal amount plus the next interest payment using the prevailing market rate for the period up to the next repricing date. Average discount rates used in 2006 and 2005 are 5.142% and 4.411%, respectively.

Other Financial Assets and Liabilities. Due to the short-term nature of the transactions, the fair values of cash and cash equivalents, receivables, short-term loans, liabilities for crude oil and petroleum product importation and accounts payable and accrued expenses approximate the carrying amounts as of balance sheet dates.

31. Registration with the BOI

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

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

a. Income Tax Holiday (ITH) for six years from actual start of Mixed Xylene commercial operations (December 1999) until 2005. On May 10, 2005, the BOI approved Petron’s application under Certificate of Registration No. DP98-148, for the one year extension of its ITH incentive. The approved bonus year is for the period December 5, 2005 to December 4, 2006;

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

c. Simplified custom procedures and others.

In October 2003, the BOI approved Petron’s application under RA No. 8479, otherwise known as the Downstream Oil Industry Deregulation Act (RA No. 8479), for new investments at its Bataan Refinery for an Isomerization Unit and a Gas Oil Hydrotreater (Project). The BOI is extending the following major incentives:

a. ITH for five years without extension or bonus year from January 2005 or actual start of commercial operations, whichever is earlier;

b. Duty of three percent and VAT on imported capital equipment and accompanying spare parts;

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

d. Exemption from contractor’s tax.

Petron has availed of ITH credits amounting to ₱736 in 2006, ₱440 in 2005 and ₱410 in 2004.

On October 20, 2005, Petron registered with the BOI under the Omnibus Investments Code of 1987 (Executive Order 226) as (1) a non-pioneer, new export producer status of Mixed Xylene; (2) a pioneer, new export producer status of Benzene and Toluene; and (3) a pioneer, new domestic producer status of Propylene. Under the terms of its registration, Petron is subject to certain requirements principally that of exporting at least seventy percent (70%) of the production of the mentioned petrochemical products every year except for the produced propylene.

As a registered enterprise, Petron is entitled to the following benefits on its Petrochemical Products (Mixed Xylene, Benzene and Toluene, and Propylene) operations:

a. ITH (1) for four years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Mixed Xylene; (2) for six years from May 2008 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Benzene and Toluene; and (3) for six years from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration for Propylene;

b. Tax credit equivalent to the national internal revenue taxes and duties paid on raw materials and supplies and semi-manufactured products used in producing its export product and forming parts thereof for ten years from start of commercial operations; and

c. Simplification of custom procedures and others.

On October 21, 2005, the BOI approved Petron's application under RA No. 8479 for new investment at its Bataan Refinery for a Petro Fluid Catalytic Cracking Unit. Subject to Petron's compliance with the terms and conditions of registration, the BOI is extending the following major incentives:

a. ITH for five years without extension or bonus year from December 2007 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to a 22% ITH rate of exemption;

b. Minimum duty of three percent and VAT on imported capital equipment and accompanying spare parts;

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

d. Exemption from contractor's tax.

In December 2005, the BOI approved Petron's application under RA No. 8479 as an Existing Industry Participant with New Investment in Modernization of the firm's Grease Manufacturing Plant in Pandacan, Manila. The BOI is extending the following major incentives:

a. ITH for a period of five years without extension or bonus year from March 2006 or actual start of commercial operations, whichever is earlier, but in no case earlier than the date of registration subject to base figure of 845 metric tons of grease product representing Petron's highest attained sales volume prior to rehabilitation;

b. Minimum duty of three percent and VAT on imported capital equipment, machinery and accompanying spare parts;

c. Tax credit on domestic capital equipment on locally fabricated capital equipment which is equivalent to the difference between the tariff rate and the three percent duty imposed on the imported counterpart;

d. Exemption from taxes and duties on imported spare parts for consigned equipment with bonded manufacturing warehouse;

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

f. Exemption from contractor's tax.

32. Segment Information

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

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

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

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

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; and

e. Export sales of various petroleum products to other Asian countries such as Cambodia, Korea, China and Australia.

The following tables present revenue and income information and certain asset and liability information regarding the business segments for the years ended December 31, 2006, 2005 and 2004. Segment assets and liabilities exclude deferred tax assets and liabilities.

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
Year Ended December 31, 2006						
Revenue:						
External sales	**₱209,395**	**₱–**	**₱–**	**₱2,331**	**₱–**	**₱211,726**
Inter-segment sales	**1,777**	**542**	**288**	**–**	**(2,607)**	**–**
Segment results	**9,101**	**516**	**268**	**78**	**(236)**	**9,727**
Net income	**5,944**	**143**	**37**	**75**	**(181)**	**6,018**
Assets and liabilities:						
Segment assets	**85,421**	**1,541**	**2,507**	**850**	**(2,804)**	**87,515**
Segment liabilities	**53,268**	**353**	**1,924**	**394**	**(2,119)**	**53,820**
Other segment information:						
Property, plant and equipment	**22,193**	**1**	**1**	**467**	**2,491**	**25,153**
Depreciation and amortization	**2,436**	**–**	**–**	**41**	**5**	**2,482**
Year Ended December 31, 2005						
Revenue:						
External sales	190,346	–	–	1,143	–	191,489
Inter-segment sales	882	539	316	–	(1,737)	–
Segment results	9,186	512	303	21	(270)	9,752
Net income	5,765	166	34	29	57	6,051
Assets and liabilities:						
Segment assets	67,185	1,366	2,347	587	(2,602)	68,883
Segment liabilities	39,519	150	1,800	205	(1,919)	39,755
Other segment information:						
Property, plant and equipment	19,797	1	1	429	2,342	22,570
Depreciation and amortization	2,315	–	–	20	–	2,335
Year Ended December 31, 2004						
Revenue:						
External sales	147,059	–	–	366	–	147,425
Inter-segment sales	297	531	249	–	(1,077)	–
Segment results	6,627	505	229	–	(211)	7,150
Net income	3,887	158	35	13	8	4,101
Assets and liabilities:						
Segment assets	61,561	1,222	2,231	419	(2,304)	63,129
Segment liabilities	39,285	137	1,674	81	(1,720)	39,457
Other segment information:						
Property, plant and equipment	20,029	2	–	163	2,252	22,446
Depreciation and amortization	1,848	–	–	8	–	1,856

The following tables present additional information on the petroleum business segment of the Company for the years ended December 31, 2006, 2005 and 2004:

	Retail	Lube	Gasul	Industrial	Marketing	Total
Year Ended December 31, 2006						
Revenue	**₱86,155**	**₱1,497**	**₱8,955**	**₱73,553**	**₱41,012**	**₱211,172**
Property, plant and equipment	**4,236**	**573**	**263**	**55**	**17,066**	**22,193**
Capital expenditures	**250**	**–**	**79**	**7**	**4,233**	**4,569**
Year Ended December 31, 2005						
Revenue	82,621	1,537	8,351	68,776	29,943	191,228
Property, plant and equipment	4,450	603	195	52	14,497	19,797
Capital expenditures	327	–	30	–	1,058	1,415
Year Ended December 31, 2004						
Revenue	65,075	1,107	7,650	54,594	18,930	147,356
Property, plant and equipment	4,608	12	206	65	15,255	20,146
Capital expenditures	577	2	37	21	4,996	5,633

Geographical Segments

The following tables present revenue and expenditure and certain asset information regarding the geographical segments of the Company for the years ended December 31, 2006, 2005 and 2004:

	Petroleum	Insurance	Leasing	Marketing	Elimination/ Others	Total
Year Ended December 31, 2006						
Revenue:						
Local	**₱176,891**	**₱495**	**₱288**	**₱2,331**	**(₱2,607)**	**₱177,398**
Export/International	**34,281**	**47**	**–**	**–**	**–**	**34,328**
Year Ended December 31, 2005						
Revenue:						
Local	167,703	465	316	1,143	(1,737)	167,890
Export/International	23,525	74	–	–	–	23,599
Year Ended December 31, 2004						
Revenue:						
Local	134,275	463	249	366	(1,077)	134,276
Export/International	13,081	68	–	–	–	13,149

33. **Other Matters**

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

In November 1999, the Department of Finance (DOF) Center ExCom cancelled Tax Debit Memos (TDMs) worth ₱475, the related TCCs and their assignments. The BIR implemented this with a letter of assessment worth ₱651 deficiency taxes (inclusive of interest and charges) for the years 1995 to 1997, as a result of the cancellation. The Company contested on the grounds that the assessment has no factual and legal basis and that the cancellation of the TDMs was void. The Company elevated this protest to the CTA on July 10, 2000. On August 23, 2006, the Second Division of the CTA rendered its decision denying Petron's petition and ordered it to pay the BIR ₱580 representing deficiency excise taxes for 1995 to 1997 plus 20% interest per annum from December 4, 1999. Petron's motion for reconsideration was denied on November 23, 2006. Petron has filed the necessary appeal with the CTA en banc and is awaiting resolution thereon.

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

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

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

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

b. Petron has unused letters of credit totaling approximately ₱257 as of December 31, 2006 and ₱30 as of December 31, 2005.

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

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

Beyond CAA compliance, Petron is the only oil company that has invested substantial resources to upgrade its production capabilities to meet CAA specifications. In January 2005, it commissioned its Isomerization Unit that will enable the Company to produce isomerates for blending with gasoline to meet current specifications. The unit is part of the ₱5,000 refinery project that also includes a Gas Oil Hydrotreater that was commissioned in April 2005. With these two units, Petron is the only oil company that can serve the local market’s demand for CAA-compliant fuels entirely from local production.

d. Pandacan Terminal Operations

The City Council of Manila (City Council), citing concerns of safety, security and health, passed City Ordinance No. 8027 (Ordinance No. 8027) reclassifying the areas occupied by the oil terminals of Petron, Shell and Chevron (formerly Caltex) from industrial to commercial, making the operation of the terminals therein unlawful.

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

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

To date, the first phase of the engineering, procurement and construction is already more than 98% complete. On the other hand, the second phase of the engineering, procurement and construction is 40% complete.

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

Simultaneous with the Scale Down Program, the case of Social Justice Society vs. Atienza (SJS vs. Atienza case) was filed on December 31, 2002. In April 2003, subsequent to the filing of the SJS vs. Atienza case, Petron, Shell and Chevron filed separate cases before the RTC questioning the constitutionality and validity of Ordinance No. 8027. Shell and Chevron were able to secure TRO and, after further proceedings, writs of preliminary injunction against the City of Manila and/or its officials from implementing Ordinance No. 8027. The separate cases of Shell and Chevron remain pending to date and the writ of injunction continue in effect. On the other hand, Petron was able to secure a status quo Order from the RTC, following an agreement between Petron and the City of Manila to maintain the status quo

Order until further orders of the Court or termination of the case. The case was referred to mediation before the Philippine Mediation Center but the parties failed to come to any agreement.

During the pendency of the above-cited cases, on March 16, 2006, the City Council passed City Ordinance No. 8119 (Ordinance No. 8119) adopting the Comprehensive Land Use Plan and Zoning Regulations of 2006 in which, the area of the Pandacan Oil Terminals was reclassified as high density residential/mixed zone use, and at the same time gave non-conforming establishments seven years from effectivity of the Ordinance No. 8119 to relocate. Shell and Chevron filed a Complaint against the City of Manila questioning the validity and constitutionality of Ordinance No. 8119 and is currently being heard for presentation of evidence by Shell and Chevron. Petron has filed its own Complaint questioning Ordinance No. 8119 before the RTC and Petron has been able to secure a TRO preventing the City of Manila from enforcing Ordinance No. 8119.

As a result of the passage of Ordinance No. 8119, on February 20, 2007, Petron, Mayor of Manila and the City Council filed a Joint Motion to Withdraw Complaint and Counterclaims in the case filed by Petron questioning Ordinance No. 8027, citing that Ordinance No. 8119 repealed Ordinance No. 8027, for which reason, the case filed by Petron before the RTC has been rendered questionable.

On March 7, 2007, the SC rendered a decision in the SJS vs. Atienza case, directing the Mayor of Manila to immediately enforce Ordinance No. 8027. It is Petron's position that the SC failed to consider supervening events, notably (i) the passage of Ordinance No. 8119 which supersedes Ordinance No. 8027, as well as (ii) the writs of injunction from the RTC presenting the implementation of Ordinance No. 8027. On March 12, 2007, Petron, together with Shell and Chevron, filed an Urgent Motion for Leave Intervention and Urgent Motion to Admit Motion for Reconsideration of the decision dated March 7, 2007, citing the foregoing grounds that make the SC's decision and the enforcement of Ordinance No. 8027 improper. Further, Petron, Shell and Chevron noted the ill-effects of the sudden closure of the Pandacan Oil Terminals on the entire country.

On March 22, 2007, the Department of Energy, through its counsel, the Office of the Solicitor General, filed a motion for the governments to intervene, in support of the oil companies' position. On March 23, 2007, Petron received an order from the SC ordering the parties to file their comments within five days from receipt of the order and setting the same for oral arguments. This order, in effect, stayed any action by the City of Manila.

The Company is in the process of finalizing the study of various alternatives. As of April 3, 2007, an estimate of the potential impact cannot be made.

e. Navotas Business Tax

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

f. Oil Spill Incident in Guimaras

M/T Solar I sank in rough seas in the afternoon of August 11, 2006 en route to Zamboanga, loaded with about 2 million liters of industrial fuel oil. It now lies about 640 meters beneath the sea, at approximately 13 nautical miles southwest of Guimaras.

Petron immediately dispatched its oil spill gear, equipment and oil spill teams upon receiving information of the incident. An aerial and surface assessment was conducted to determine the extent of the oil spill.

Inspection by the Survey Ship Shinsei Maru (Shinsei Maru), using a remote-operated vehicle (ROV), found the vessel upright and in stable condition with minimal traces of leakage. All cargo compartment valves were tightened by the ROV to ensure against further leakage. The Shinsei Maru was contracted by the Protection and Indemnity (P & I) Club and the International Oil Pollution Compensation (IOPC) from Fukada Salvage & Marine Works Co. Ltd.

On separate investigations conducted by the Special Task Force on Guimaras by the Department of Justice (DOJ) and the Special Board of Marine Inquiry (SBMI), both found the owners of M/T Solar I, Sunshine Marine Development Corporation (SMDC), liable. The DOJ found no criminal liability on the part of Petron. However, the SBMI found Petron to have overloaded the vessel. Petron has appealed the findings of the SBMI to the Department of Transportation and Communication and is awaiting its resolution.

On September 18, 2006, the Mayor of Nueva Valencia, Guimaras filed a criminal complaint before the Fiscal's Office in Guimaras against Petron officers and the President of SMDC for violation of environmental laws. A resolution was issued by the public prosecutor dismissing the criminal complaint on all counts. A Motion for Reconsideration was filed by the counsel for Guimaras Municipality last April 4, 2007; on the other hand, the counsel for Petron filed opposition to the Motion for Reconsideration. The Company is awaiting resolution on this incident.

The Company implemented a "Cash for Work" program involving residents of the affected areas in the clean-up operations, providing them with a daily allowance. The Company also mobilized its employees to assist in the operations. By the middle of November 2006, Petron had cleaned up all affected shorelines and was affirmed by the inspections made by Task Force Solar I Oil Spill (SOS), a multi-agency group composed of officials from the Local Government Units, Department of Health, Department of Environment and Natural Resources, Department of Social Welfare and Development (DSWD), and the Philippine Coast Guard.

The Company collected a total of 6,000 metric tons of debris which were brought to the Holcim Cement facility in Lugait, Misamis Occidental for processing/treatment of waste. On November 20, 2006, one of the last barge shipments of oil debris unfortunately sank en route to the same plant.

The Company is working closely with the provincial government, DSWD, Department of Agriculture, Technical Education and Skills Development Authority and the Philippine Business for Social Progress in developing livelihood programs for the locals. Last November 27, 2006, Petron held a scientific conference in cooperation with the University of the Philippines - Visayas, the National Disaster Coordinating Council, the World Wildlife Fund and the Guimaras Provincial Government with the objective of developing an integrated assessment and protocol for the rehabilitation of the province. The Company has also replicated its own educational programs in partnership with the Department of Education. Ground breaking ceremonies for the construction of a four-classroom school in Barangay Tando, Nueva Valencia and a Library Hub in Barangay San Miguel, Jordan, Guimaras was held last March 15, 2007. The two facilities are expected to be open in time for the next school year.

With regard to the retrieval of the remaining oil still trapped in M/T Solar I, the P & I Club contracted a sub-sea systems technology provider (Sonsub) to recover the oil from the sunken vessel. The recovery vessel, Allied Shield, arrived at Bacolod Real Estate Development Corporation Pier in Bacolod City last March 10, 2007. After unloading the ISO-certified tanks and hoses, the vessel proceeded to the site in March 11, 2007. Oil recovery operation was technically completed on April 1, 2007. A total of 9,000 liters of oil was recovered.

Representatives from the IOPC met with the claimants from various affected areas of Guimaras to give an orientation on the requirements of the claim as well as the documents required to be submitted in support of the claim. Petron has filed a total of ₱188 against the IOPC. As of January 2007, a total of ₱105 has been paid to Petron. Payment of claims for Guimaras fishermen were completed in March 2007. Release of checks for Iloilo claimants will start on the second week of April 2007.

Total expenses incurred as of December 31, 2006 amounted to ₱122, net of reimbursements from IOPC amounting to ₱105 (see Note 18).

COVER SHEET

3 1 1 7 1

SEC Registration Number

PETRON CORPORATION AND SUBSIDIARIES

(Company's Full Name)

Petron MegaPlaza, 358 Sen. Gil Puyat Avenue, Makati City

(Business Address: No. Street City/Town/Province)

Luis A. Maglaya

(Contact Person)

886-3888

(Company Telephone Number)

1 2 3 1

Month *Day*

(Fiscal Year)

1 7 - A

(Form Type)

Month *Day*

(Annual Meeting)

(Secondary License Type, If Applicable)

Dept. Requiring this Doc.

Amended Articles Number/Section

Total Amount of Borrowings

Total No. of Stockholders

Domestic

Foreign

To be accomplished by SEC Personnel concerned

File Number

LCU

Document ID

Cashier

STAMPS

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PETRON CORPORATION AND SUBSIDIARIES

SUPPLEMENTARY SCHEDULES
TO THE CONSOLIDATED FINANCIAL STATEMENTS
REQUIRED BY THE SECURITIES AND EXCHANGE COMMISSION
FOR THE YEAR ENDED DECEMBER 31, 2006
AND AUDITORS' REPORT

Philippine Pesos

PETRON CORPORATION AND SUBSIDIARIES
INDEX TO SUPPLEMENTARY SCHEDULES
FORM 17-A, Item 7

PETRON

STATEMENT OF MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The management of Petron Corporation is responsible for all information and representations contained in the consolidated balance sheets as of December 31, 2006 and 2005, and the related consolidated statements of income, recognized income and expense and cash flows for the years ended December 31, 2006, 2005 and 2004. The financial statements have been prepared in conformity with generally accepted accounting principles in the Philippines and reflect amounts that are based on the best estimates and informed judgment of management with an appropriate consideration to materiality.

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

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

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

NICASIO I. ALCANTARA
Chairman and Chief Executive Officer

KHALID D. AL-FADDAGH
President

ANTONIO G. PELAYO
Vice President - Finance and Subsidiaries

MA. CONCEPCION F. DE CLARO
Controller

SUBSCRIBED AND SWORN TO before me, a Notary Public for and in the City of Makati, Metro Manila, this APR 13 2007, affiants being personally known to me and signed this instrument in my presence and avowed under penalty of law to the whole truth of contents thereof.

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Page No. 31;
Book No. XVIII;
Series of 2007

VICENTE R. MARQUEZ
Notary Public for Makati City
Notary Commission No. M-216
Until December 31, 2007
PTR No. 0267945 1.3.07 Makati
LRN - 01893 5.25.00 Pasig
Roll of Attorney No. 35074
PETRON Mega Plaza Bldg.,
358 Sen. Gil Puyat Ave., Makati City

SGV & Co

SyCip Gorres Velayo & Co.
6760 Ayala Avenue
1226 Makati City
Philippines

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www.sgv.com.ph

BOA/PRC Reg. No. 0001
SEC Accreditation No. 0012-FR-1

**INDEPENDENT AUDITORS' REPORT
ON SUPPLEMENTARY SCHEDULES**

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

We have audited in accordance with Philippine Standards on Auditing, the consolidated financial statements of Petron Corporation and Subsidiaries included in this Form 17-A and have issued our report thereon dated April 3, 2007. Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules listed in the Index to Financial Statements and Supplementary Schedules are the responsibility of the Company's management. These schedules are presented for purposes of complying with Securities Regulation Code Rule 68 and are not part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly state in all material respect the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

SYCIP GORRES VELAYO & CO.

Wilson P. Tan

Wilson P. Tan
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-AR-1
Tax Identification No. 102-098-469
PTR No. 0267394, January 2, 2007, Makati City

April 3, 2007

PETRON CORPORATION AND SUBSIDIARIES
SCHEDULE E. INTANGIBLE ASSETS - OTHER ASSETS
December 31, 2006

Description	Beginning Balance	Additions at Cost	Charged to Cost and Expenses	Charged to Other Accounts	Other Changes Additions (Deductions)	Ending Balance
SAP Software:						
Cost	₱ 10,079,122	₱	₱	₱ -	₱ -	₱ 10,079,122
Less amortization for the year		-	10,079,122	-	-	10,079,122
Net book value	10,079,122	-	10,079,122	-	-	-
Franchise Fee:						
Cost	4,302,182	2,200,000	-	-	-	6,502,182
Less amortization for the year	-	-	828,682	-	-	828,682
Net book value	4,302,182	2,200,000	828,682	-	-	5,673,500
BALANCE	₱ 14,381,304	₱ 2,200,000	₱ 10,907,804	₱ -	₱ -	₱ 5,673,500

PETRON CORPORATION AND SUBSIDIARIES
SCHEDULE F. LONG-TERM DEBT
December 31, 2006

Title of Issue and Type of Obligation	Amount Authorized by Indenture	Amount Shown Under Caption "Current portion of long-term debt" in Related Balance Sheet	Amount Shown Under Caption "Long-term debt" in Related Balance Sheet	Terms
Syndicated dollar bank loans:				
Nordeutsche Landesbank Girozentrale (net of debt issue costs amounting to ₱58,252,028)	₱ 4,373,651,000	₱ 1,325,262,188	₱ 3,048,388,812	interest - 5.7% to 6.8%; six semi-annual installments starting on the 30th month from June 2004 up to June 2009.
	4,373,651,000	1,325,262,188	3,048,388,812	
Unsecured peso loans:				
Citibank NA	307,692,308	307,692,308	-	interest - 6.7% to 8.2%; 13 equal quarterly installments starting April 2004 up to April 2007.
BPI-ING (net of debt issue cost amounting to ₱59,814,031)	6,240,185,969	-	6,240,185,969	interest - 8.875%; one time payment in August 2011
LBP (net of debt issue cost amounting to ₱9,777,557)	1,990,222,442	-	1,990,222,442	interest - 6.1%; 12 equal quarterly installments starting March 2009 up to November 2011.
	8,538,100,719	307,692,308	8,230,408,411	
TOTAL	**₱ 12,911,751,719**	**₱ 1,632,954,496**	**₱ 11,278,797,223**	

PETRON CORPORATION AND SUBSIDIARIES
SCHEDULE I. CAPITAL STOCK
December 31, 2006

Title of Issue	Number of Shares Authorized	Number of Shares Issued and Outstanding at Shown Under Related Balance Sheet	Number of Shares Reserved for Options, Warrants, Conversions, and Other Rights	Number of Shares Held By		
				Related Parties	Directors, Officers and Employees	Others
Common Stock	10,000,000,000	9,375,104,497		7,500,000,013	3,059,068	1,872,045,416