20040414-580

COVER SHEET

PETRON CORPORATION
(Company's Full Name)

Petron Mega Plaza, 358 Sen. Gil Puyat Ave., Makati City, Philippines
(Company's Address)

886-3888
(Company's Telephone Number)

December 31, 2003
(Fiscal Year Ending)
(Month & Day)

July 28, 2003
(Annual Meeting)

SEC FORM 17-A

(FORM TYPE)

(Amendment Designation if Applicable)

(Secondary License Type, if any)

LCU

Cashier

DTU

31171
S.E.C. Reg. No.

Central Receiving Unit

File Number

Document I.D.

SGV & Co

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

Report of Independent Auditors

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

We have audited the accompanying consolidated balance sheets of Petron Corporation and Subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Petron Corporation and Subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003 in conformity with the accounting principles generally accepted in the Philippines.

SyCip Gorres Velayo & Co.

W. P. TAN
Partner
CPA Certificate No. 76737
SEC Accreditation No. 0100-A
Tax Identification No. 102-098-469
PTR No. 7012889
January 5, 2004
Makati City

March 24, 2004

PETRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in Millions)

	December 31	
	2003	2002
ASSETS		
Current Assets		
Cash and cash equivalents (Note 3)	₱2,803	₱5,419
Short-term investments - net (Note 4)	69	57
Receivables - net (Note 5)	9,402	9,673
Inventories - net (Notes 6, 18 and 20)	15,674	11,477
Deferred income tax assets - net (Note 15)	705	1,216
Other current assets	730	550
Total Current Assets	29,383	28,392
Noncurrent Assets		
Investments - net (Note 7)	857	558
Property, plant and equipment - net (Notes 8 and 25)	21,497	21,531
Other noncurrent assets (Note 9)	80	95
Total Noncurrent Assets	22,434	22,184
	₱51,817	₱50,576
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Short-term loans (Note 10)	₱15,386	₱12,105
Liabilities for crude oil and petroleum product importation (Note 18)	6,560	4,731
Accounts payable and accrued expenses (Note 11)	3,355	3,298
Current portion of long-term debt (Note 12)	712	5,325
Total Current Liabilities	26,013	25,459
Noncurrent Liabilities		
Long-term debt - net of current portion (Note 12)	3,288	4,000
Deferred income tax liabilities - net (Note15)	2,044	1,789
Other noncurrent liabilities (Note 13)	400	507
Total Noncurrent Liabilities	5,732	6,296
Stockholders' Equity (Note 14)		
Capital stock	9,375	9,375
Retained earnings:		
Appropriated	5,551	5,551
Unappropriated	5,027	3,794
Accumulated translation adjustments	119	101
Total Stockholders' Equity	20,072	18,821
	₱51,817	₱50,576

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

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES
Mixed Xylene Operation

STATEMENTS OF INCOME
(Amounts in Millions, Except Sales Volume)

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

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED DECEMBER 31, 2003

(Amounts in Millions, Except Per Share Amounts)

	Capital Stock	Retained Earnings (Note 14)		Accumulated Translation	
	(Note 14)	Appropriated	Unappropriated	Adjustments	Total
Balance at December 31, 2000	₱9,375	₱2,319	₱4,294	₱82	₱16,070
Net income for the year	–	–	1,224	–	1,224
Appropriated for capital projects	–	2,293	(2,293)	–	–
Foreign currency translation adjustments	–	–	–	9	9
Balance at December 31, 2001	9,375	4,612	3,225	91	17,303
Net income for the year	–	–	2,914	–	2,914
Appropriated for capital projects	–	939	(939)	–	–
Cash dividends - ₱0.15/share	–	–	(1,406)	–	(1,406)
Foreign currency translation adjustments	–	–	–	10	10
Balance at December 31, 2002	9,375	5,551	3,794	101	18,821
Net income for the year	–	–	3,108	–	3,108
Cash dividends - ₱0.20/share	–	–	(1,875)	–	(1,875)
Foreign currency translation adjustments	–	–	–	18	18
Balance at December 31, 2003	**₱9,375**	**₱5,551**	**₱5,027**	**₱119**	**₱20,072**

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in Millions)

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

See accompanying Notes to Consolidated Financial Statements.

PETRON CORPORATION AND SUBSIDIARIES

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

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

The registered office address of Petron and its Philippine-based subsidiaries is Petron MegaPlaza, 358 Sen. Gil Puyat Avenue, Makati City. The number of employees of Petron and subsidiaries is 1,212 as of December 31, 2003 and 1,198 as of December 31, 2002.

The consolidated financial statements were authorized for issue by the Board of Directors on March 24, 2004.

2. Summary of Significant Accounting Policies

The principal accounting policies adopted in preparing the consolidated financial statements of Petron and subsidiaries are as follows:

Basis of Preparation

The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the Philippines under the historical cost convention.

Use of Estimates

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

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

The Company and subsidiaries adopted the following new SFAS/IAS, which became effective for financial statements covering periods beginning on or after January 1, 2003:

- SFAS 10/IAS 10, "Events After the Balance Sheet Date," prescribes the accounting policies and disclosures related to adjusting and non-adjusting subsequent events. Additional disclosures required by the standard were included in the consolidated financial statements, principally the date of authorization for release of the consolidated financial statements.

- SFAS 22/IAS 22, "Business Combinations," requires that an acquisition where an acquirer can be identified should be accounted for by the purchase method. Any goodwill arising from the acquisition should be amortized generally over 20 years.

- SFAS 37/IAS 37, "Provisions, Contingent Liabilities and Contingent Assets," provides the criteria for the recognition and bases for measurement of provisions, contingent liabilities and contingent assets.

- SFAS 38/IAS 38, "Intangible Assets," establishes the criteria for the recognition and measurement of intangible assets. It also requires that expenditures on research, start-up, training, advertising and relocation be expensed as incurred.

Adoption of these new standards in 2003 did not result in restatement of prior years consolidated financial statements. Additional disclosure requirements were included in the 2003 and 2002 consolidated financial statements, where applicable.

New Accounting Standards Effective Subsequent to 2003

The Accounting Standards Council approved the following accounting standards, which will be effective subsequent to 2003:

- SFAS 12/IAS 12, "Income Taxes," prescribes the accounting treatment for current and deferred income taxes. The standard requires the use of the balance sheet liability method in accounting for deferred income taxes. It requires the recognition of a deferred tax liability and, subject to certain conditions, deferred tax asset for all temporary differences with certain exceptions. The standard provides for the recognition of a deferred tax asset when it is probable that taxable income will be available against which the deferred tax asset can be used. It also provides for the recognition of a deferred tax liability with respect to asset revaluations. The Company will adopt the SFAS 12/IAS 12 in 2004, and has not yet determined the financial impact of the adoption of this standard.

- SFAS 17/IAS 17, "Leases," prescribes the accounting policies and disclosures to apply to finance and operating leases. Finance leases are those that transfer substantially all risks and rewards of ownership to the lessee. The Company will adopt the SFAS 17/IAS 17 in 2004, and has not yet determined the financial impact of the adoption of this standard.

- SFAS 21/IAS 21, "The Effects of Changes in Foreign Exchange Rates," provides restrictive conditions for the capitalization of foreign exchange losses. The Company will adopt the standard in 2005 on a retroactive basis. As of December 31, 2003, undepreciated capitalized losses included in property, plant and equipment amounted to ₱2,411 (see Note 8). Upon adoption of SFAS 21/IAS 21 in 2005, any undepreciated capitalized foreign exchange losses will be adjusted against beginning retained earnings and prior years consolidated financial statements presented will be restated.

Basis of Consolidation and Investments

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

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

The consolidated subsidiaries include Overseas Ventures Insurance Corporation Ltd. (Ovincor, a 100%-owned subsidiary incorporated under the laws of Bermuda), Petrogen Insurance Corporation (Petrogen, 100%-owned subsidiary), New Ventures Realty Corporation and subsidiary (NVRC, 79.95%-owned subsidiary in 2003 and 50%-owned subsidiary in 2002) and Petron Treats Subic Inc. (PTSI), a new wholly owned subsidiary incorporated on November 6, 2003. Petrogen, NVRC and PTSI were incorporated under the laws of the Republic of the Philippines.

NVRC's primary purpose is to acquire real estate and derive income therefrom from its sale or lease. Petrogen and Ovincor are engaged in the business of insurance and re-insurance. The primary purpose of PTSI is to, among others, sell on wholesale or retail, and operate service stations, retail outlets, restaurants, convenience stores and the like. PTSI's service station is expected to be operational in 2004.

In prior years, the accounts of NVRC are included in the consolidation since Petron retains financial and operating control. In 2003, the Company purchased additional shares of NVRC increasing its ownership from 50% to 79.95%.

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

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

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

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

Investments in Marketable Equity Securities
Investments in marketable equity securities, shown under "Short-term investments" account in the consolidated balance sheets, are stated at the lower of aggregate cost or market value determined as of balance sheet date. The amount by which aggregate cost exceeds market value is accounted for as a valuation allowance with a charge to current operations. The cost of marketable equity securities used for determining the gain or loss on the sale of such securities is computed using the average method.

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

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

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

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

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

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

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

The initial cost of property, plant and equipment comprises its purchase price, including import duties and taxes and any directly attributable costs of bringing the assets to their working condition and location for their intended use. Cost also includes foreign exchange losses arising from the restatement of long-term foreign currency-denominated loans up to 2001 and interest incurred during the construction period on funds borrowed to finance the acquisition and/or construction of the projects. Expenditures incurred after the property, plant and equipment have

been put into operation, such as repairs and maintenance and overhaul costs, are normally charged to income in the period the costs are incurred. In situations where it can be clearly demonstrated that the expenditures have resulted in an increase in the future economic benefits expected to be obtained from the use of an item of property, plant and equipment beyond its originally assessed standard of performance, the expenditures are capitalized as an additional cost of property, plant and equipment. When assets are retired or otherwise disposed of, the cost and the related accumulated depreciation, amortization and impairment loss, if any, are removed from the accounts and any resulting gain or loss is credited or charged to current operations.

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

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

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

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

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

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

Asset Impairment

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

Goodwill
Goodwill represents the excess of the cost of the acquisition over the fair value of identifiable net assets of a subsidiary at the date of acquisition. Goodwill is stated at cost less accumulated amortization and any impairment in value. Goodwill is amortized on a straight-line basis over its useful economic life up to a presumed maximum of 20 years. It is reviewed for impairment when events or changes in circumstances indicate that the carrying amount may not be recoverable.

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

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

Starting 2003, the Company maintains the balance of cylinder deposits at an amount equivalent to three days worth of inventory of its biggest dealers, but in no case lower than ₱200 million at any given time, to take care of possible returns by dealers.

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

Provisions
Starting 2003, provisions are recognized when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessment of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognized as an interest expense.

In prior years, provisions for contingencies were accrued when it is probable that a liability had been incurred at balance sheet date and the amount can be reasonably estimated. Otherwise, the loss contingency was disclosed.

Revenue Recognition
Sale is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred, title has transferred, selling price is fixed or determinable and collectibility of the selling price is reasonably assured. Interest is recognized on a time proportion basis that reflects the effective yield on the assets.

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

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

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

Operating Lease
Lease payments under operating lease arrangements are recognized as expense over the term of the lease.

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

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

Income Taxes
Deferred income tax is provided using the balance sheet liability method. Deferred tax assets and liabilities are recognized for the: (a) future tax consequences attributable to temporary differences between the financial reporting bases of assets and liabilities and their related tax bases; (b) carry forward benefit of the excess of the minimum corporate income tax (MCIT) over the regular corporate income tax; and, (c) net operating loss carryover (NOLCO). Deferred tax assets and liabilities are measured using the tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled and NOLCO and MCIT are expected to be applied. A valuation allowance is provided for deferred tax assets when it is more likely than not that some or all of the deferred tax assets will not be realized in the future.

Contingencies
Contingencies are not recognized in the consolidated financial statements. They are disclosed unless the possibility of an outflow of resources embodying economic benefits is remote.

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

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

3. Cash and Cash Equivalents

	2003	2002
Cash on hand and in banks	₱2,123	₱2,381
Money market placements	680	3,038
	₱2,803	₱5,419

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

4. Short-term Investments

	2003	2002
Marketable equity securities - net	₱44	₱32
Short-term cash investments	25	25
	₱69	₱57

Marketable equity securities are carried at cost, net of allowance for market decline amounting to ₱36 as of December 31, 2003 and ₱48 as of December 31, 2002.

	2003	2002
Gross unrealized gains from current marketable equity securities	₱20	₱19
Gross unrealized losses from current marketable equity securities	(56)	(67)
Net realized gain from current marketable equity securities included in net income	12	5

5. Receivables

	2003	2002
Trade	₱8,100	₱8,034
Others	1,881	2,218
	9,981	10,252
Less allowance for doubtful accounts	579	579
	₱9,402	₱9,673

6. Inventories

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

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

7. Investments

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

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

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

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

8. Property, Plant and Equipment

	Buildings and Related Facilities	Refinery and Plant Equipment	Service Stations and Other Equipment	Computers, Office and Motor Equipment	Land and Leasehold Improvements	Construction-in-Progress	Total
Net carrying amount, at January 1, 2003	₱5,531	₱12,154	₱405	₱266	₱2,126	₱1,049	₱21,531
Additions*	–	–	–	–	560	1,504	2,064
Transfers	104	410	246	160	31	(951)	–
Depreciation and amortization charges for the year	(355)	(1,394)	(141)	(95)	(113)	–	(2,098)
Net carrying amount, at December 31, 2003	₱5,280	₱11,170	₱510	₱331	₱2,604	₱1,602	₱21,497
At January 1, 2003							
Cost	₱7,060	₱20,380	₱2,593	₱1,468	₱2,865	₱1,049	₱35,415
Accumulated depreciation and amortization	(1,529)	(8,226)	(2,188)	(1,202)	(739)	–	(13,884)
Net carrying amount	₱5,531	₱12,154	₱405	₱266	₱2,126	₱1,049	₱21,531

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

	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, 2003							
Cost	₱7,156	₱20,142	₱2,767	₱1,508	₱3,371	₱1,602	₱36,546
Accumulated depreciation and amortization	(1,876)	(8,972)	(2,257)	(1,177)	(767)	-	(15,049)
Net carrying amount	₱5,280	₱11,170	₱510	₱331	₱2,604	₱1,602	₱21,497

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

9. Other Noncurrent Assets

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

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

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

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

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

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

The cash outflow on acquisition is as follows:

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

The negative goodwill and goodwill arising from the increase in ownership in NVRC and NVRC's acquisition of Las Lucas, respectively, are presented in the 2003 balance sheet net of income tax effect amounting to ₱126 pertaining to the fair value adjustment on the land. Goodwill will be amortized starting 2004.

10. Short-term Loans

This account pertains to unsecured peso loans obtained from local banks at prevailing interest rates and intended to fund the importation of crude oil and petroleum products, capital expenditures and working capital requirements.

11. Accounts Payable and Accrued Expenses

	2003	2002
Accounts payable	₱536	₱503
Accrued expenses	708	940
Specific and other taxes payable	438	412
Others	1,673	1,443
	₱3,355	₱3,298

Accounts payable - others include unearned income arising from trade related transactions.

12. Long-term Debt

	2003	2002
Unsecured peso loans	₱4,000	₱4,000
Syndicated dollar bank loan	–	5,325
	4,000	9,325
Less current portion	712	5,325
	₱3,288	₱4,000

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

Original Amount	Syndicated dollar loan - US$120 million	Landbank - ₱2 billion	Citibank - ₱2 billion
Payment Terms	$20 million paid in 2002 and $100 million paid in 2003	8 equal quarterly installments over 4 years up to September 2006, inclusive of two-year grace period	13 equal quarterly installments starting April 2004 up to April 2007
Interest	Six-month LIBOR plus certain spread	91-day T-bill rate plus a fixed spread	91-day T-bill rate plus a fixed spread
Security	None	None	None
Major Covenants	Maintenance of certain financial ratios	Maintenance of certain financial ratios	Maintenance of certain financial ratios

As of December 31, 2003, the Company is in compliance with its loan covenants. Loan maturities for the next 4 years are as follows:

Year	Amount
2004	₱712
2005	1,615
2006	1,365
2007	308
	₱4,000

13. Other Noncurrent Liabilities

	2003	2002
Cylinder deposits	₱256	₱387
Minority interest	103	107
Others	41	13
	₱400	₱507

14. Stockholders' Equity

a. Capital Stock

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

b. Retained Earnings

i. This account includes Petron's accumulated equity in net earnings of subsidiaries of ₱747 in 2003 and ₱596 in 2002, which are not currently available for dividend declaration.

ii. Declaration of Cash Dividends

In 2003, the Company declared a cash dividend of ₱0.20/share amounting to ₱1,875 to all stockholders of record as of May 29, 2003. In 2002, a cash dividend of ₱0.15/share amounting to ₱1,406 was declared to all stockholders of record as of June 6, 2002.

iii. Appropriation for Capital Projects

Petron appropriated ₱939 in 2002 and ₱2,293 in 2001 for future capital projects.

15. Income Taxes

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

	2003	2002
Current:		
Deferred tax assets:		
Inventory differential	₱657	₱674
Unrealized foreign exchange loss on short-term loans	13	62
MCIT	–	420
Various allowances, accruals and others	383	392
	1,053	1,548
Less deferred tax liability -		
Capitalized taxes and duties on inventories deducted in advance	348	332
	₱705	₱1,216
Noncurrent:		
Deferred tax liabilities:		
Excess of double declining over straight-line method of depreciation and amortization	₱1,074	₱1,048
Fair market value adjustment on land in a purchase acquisition	126	–
Capitalized foreign exchange losses, interest, duties and taxes on property, plant and equipment deducted in advance and others	893	818
	2,093	1,866
Less deferred tax asset -		
Unamortized past service pension costs	49	77
	₱2,044	₱1,789

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

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

16. **Cost of Goods Sold**

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

17. **Expenses**

a. Operating Expenses

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

b. Interest

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

18. Related Party Transactions

The significant transactions with related parties are as follows:

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

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

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

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

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

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

19. Pension Plan

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

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

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

20. Supplementary Information

a. Processing License Agreement

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

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

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

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

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

21. Earnings Per Share (EPS)

	2003	2002	2001
Net income	**₱3,108**	₱2,914	₱1,224
Weighted average number of shares	**9,375,000,000**	9,375,000,000	9,375,000,000
EPS	**₱0.33**	₱0.31	₱0.13

22. Supplemental Disclosures of Cash Flow Information

a. Changes in operating assets and liabilities

	2003	2002	2001
Decrease (increase) in assets:			
Receivables - trade	**(₱268)**	(₱1,062)	(₱156)
Inventories	**(4,304)**	69	(1,093)
Other current assets	**(163)**	(254)	(49)
Increase (decrease) in liabilities:			
Liabilities for crude oil and petroleum product importation	**1,825**	1,702	(2,349)
Accounts payable and accrued expenses	**(53)**	(393)	(657)
	(2,963)	62	(4,304)
Provisions for (reversal of allowance for) doubtful accounts, inventory obsolescence and others	**199**	(175)	(82)
	(₱2,764)	(₱113)	(₱4,386)

b. Acquisition of a subsidiary by NVRC

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

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

23. Financial Instruments

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

As of December 31, 2003 and 2002, the Company has outstanding commodity price swaps covering industrial fuel oil with an aggregate notional quantity of 64,614 and 120,000 metric tons (MT), and a weighted average fixed rate of US$156.78 and US$156 per MT, respectively. The net mark-to-market losses on these swaps amounted to ₱32 and ₱26 in 2003 and 2002, respectively. Also, as of December 31, 2003 and 2002, the Company has outstanding commodity price swaps covering Dubai crude oil with an aggregate notional quantity of 420,000 barrels and 780,000 barrels, and a weighted average fixed rate of US$25 and US$25.17 per barrel, respectively. The net mark-to-market gains on these swaps amounted to ₱66 and ₱6, respectively.

The Company also entered into deliverable and non-deliverable short-term currency forward contracts to hedge its foreign currency exposure on crude oil importations. As of December 31, 2003 and 2002, the Company has outstanding currency forward contracts with an aggregate notional amount of US$55 and US$59.18, and weighted average contracted forward rate of ₱55.75 to US$1 and ₱53.86 to US$1, respectively. The net mark-to-market losses on these currency forward contracts amounted to ₱1 and ₱31, respectively.

The Company also enters into short-term currency swap agreements with local financial institutions. These contracts are entered into for liquidity purposes and as a source of financing. Under the swaps, the Company sells US dollars at spot and buys back the same amount at a forward rate on a specified date. As of December 31, 2003, the Company has no outstanding currency swap contracts.

Under current accounting practice, the unrealized mark-to-market losses on the outstanding derivative contracts as of December 31, 2003 and 2002 are presented for disclosure purposes only and are not included in the determination of net income.

24. Registration with the Board of Investments (BOI)

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

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

a. Income Tax Holiday (ITH) for six years from actual start of Mixed Xylene commercial operations (December 5, 1999);

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

c. Simplified custom procedures and others.

Petron has availed of ITH credits amounting to ₱288 in 2003, ₱117 in 2002 and ₱17 in 2001.

In October 2003, the BOI approved Petron's application under R.A. 8479, otherwise known as the Oil Deregulation Law, for new investments at its Bataan Refinery for an Isomerization Unit and a Gasoil 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 Value Added Tax (VAT) on imported capital equipment and accompanying spare parts;

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

d. Exemption from contractor's tax.

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

25. Segment Information

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

Petron's major sources of revenues are as follows:

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

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

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

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

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

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

	Retail	Lube	Gasul	Industrial	Others	Total
Year Ended December 31, 2003						
Revenue	₱48,676	₱947	₱6,415	₱36,438	₱18,261	₱110,737
Property, plant and equipment	4,046	12	38	62	15,217	19,375
Year Ended December 31, 2002						
Revenue	₱40,275	₱802	₱5,591	₱30,440	₱15,222	₱92,330
Property, plant and equipment	3,862	6	102	68	15,931	19,969

Geographical segments

The following tables present revenue and expenditure and certain asset information regarding the geographical segments of the Company for the years ended December 31, 2003 and 2002:

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

26. **Other Matters**

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

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

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

In the TCC-related criminal cases, two of which have been filed by the Office of the Ombudsman with the Sandiganbayan and three 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.

b. Petron has unused letters of credit totaling approximately ₱4 as of December 31, 2003 and ₱5 as of December 31, 2002.

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

In line with its commitment to make available Clean Air Act (CAA) - compliant automotive diesel oil (ADO) at the earliest possible time, Petron launched its low-sulfur "Diesel Max" in Metro Manila in the early part of October 2003 - almost three months ahead of the original schedule. Under the CAA law, oil firms are mandated to lower the sulfur content of ADO to 0.05% by January 1, 2004 nationwide. Petron's low-sulfur diesel is now available in all its service stations across the country.

Beyond CAA compliance, the Company has invested about $100 for an Isomerization Unit and a Gas Oil Hydrotreater at its Bataan Refinery. These additional facilities are expected to be on-stream towards the end of 2004 and will make Petron the only refiner in the country capable of producing CAA fuels to meet its requirements.

d. Scale Down of Pandacan Terminal Operations

On December 17, 2003, Petron inaugurated its Pandacan Linear Park, which will serve as an additional safety and security buffer zone for residents in the surrounding area.

The establishment of the Linear Park is an important commitment made by Petron, together with Shell and Caltex, under a Memorandum of Understanding (MoU) signed with the City of Manila and the Department of Energy in 2002. Other commitments include the dismantling of 28 product storage tanks and the creation of a joint venture (JV) company that will operate the reduced facilities.

The oil companies have finalized discussions on the commercial agreement that would govern the management and operations of the JV company. The JV is expected to be formed and registered with the SEC by early 2004, and will take over the operations of the scaled down Pandacan terminal around the end of the first quarter of 2004.

To date, the three companies have decommissioned and dismantled 26 out of the 28 tanks committed to be removed under the MoU. The last two tanks will be removed by March 2004.

e. Navotas Business Tax

On March 4, 2002, the Municipality of Navotas assessed Petron the amount of ₱10 as business tax on 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 May 5, 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 (SC) with a prayer for a temporary restraining order (TRO).

On August 6, 2003, the SC issued a TRO against the Mayor and the Municipal Treasurer of Navotas which enjoined the latter from closing Petron's Navotas oil depot. On December 8, 2003, the SC gave due course to the petition and ordered the respondents to file their comments.