

COVERSHEET

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S. E. C. Registration Number

P E T R O N C O R P O R A T I O N

(Company's Full Name)

S M C H E A D O F F I C E 4 0 S A N M I G U E L

A V E. M A N D A L U Y O N G C I T Y

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

ATTY. JOEL ANGELO C. CRUZ

Contact Person

886-3888

Company Telephone Number

1 2 1 1

Month Day

Fiscal Year

SEC Form 17-Q (2nd Quarter 2012)

FORM TYPE

0 7 1 2

Month Day

Annual Meeting

N/A

Secondary License Type, if Applicable

Dept. Requiring this Doc.

N/A

Amended Articles Number/Section

Total No. of Stockholders

Total Amount of Borrowings

Domestic

N/A

Foreign

To be accomplished by SEC Personnel concerned

Fiscal Numer

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SECURITIES AND EXCHANGE COMMISSION

SEC FORM 17-Q

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

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

Title of Each Class	Number of Shares of Common Stock Outstanding and Amount of Debt Outstanding
<u>Common Stock</u>	<u>9,375,104,497 Shares</u>
<u>Preferred Stock</u>	<u>100,000,000 Shares</u>
<u>Total Liabilities</u>	<u>P167,151 million</u>

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

Yes No

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

Philippine Stock Exchange

Common and Preferred Stocks

12. Indicate by check mark whether the Registrant:

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

Yes No

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

Yes No

PART I - FINANCIAL INFORMATION		
Item 1	Financial Statements	
	Petron Corporation & Subsidiaries Consolidated Statements of Financial Position	5
	Petron Corporation & Subsidiaries Consolidated Statements of Income	6
	Petron Corporation & Subsidiaries Consolidated Statements of Comprehensive Income	7
	Petron Corporation & Subsidiaries Consolidated Statements of Changes in Equity	8
	Petron Corporation & Subsidiaries Consolidated Statements of Cash Flows	9
	Selected Notes to Consolidated Financial Statements	10-53
	Details of Accounts Receivables	54
Item 2	Management's Discussion and Analysis of Financial Conditions and Results of Operations	55-60
PART II - OTHER INFORMATION		
SIGNATURES		61



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

	<i>Note</i>	2012 Unaudited	2011 Audited
ASSETS			
Current Assets			
Cash and cash equivalents	<i>9,10</i>	P 16,882	P 23,823
Financial assets at fair value through profit or loss	<i>9,10</i>	294	237
Trade and other receivables - net	<i>9,10</i>	40,042	26,605
Inventories		59,827	37,763
Other current assets		16,346	8,178
		133,391	96,606
Assets held for sale		10	10
Total Current Assets		133,401	96,616
Noncurrent Assets			
Property, plant and equipment - net	<i>4</i>	75,971	50,446
Investments in associates		1,181	2,505
Investment property - net		749	794
Available-for-sale financial assets	<i>9,10</i>	931	1,036
Deferred tax assets		92	15
Goodwill		10,087	-
Other noncurrent assets - net	<i>9,10</i>	19,682	24,383
Total Noncurrent Assets		108,693	79,179
		P 242,094	P 175,795
LIABILITIES AND EQUITY			
Current Liabilities			
Short-term loans	<i>9,10</i>	P 75,554	P 40,593
Liabilities for crude oil and petroleum product importation	<i>9,10</i>	31,145	13,842
Trade and other payables	<i>9,10</i>	8,206	7,381
Derivative liabilities	<i>9,10</i>	55	55
Current portion of long-term debt - net	<i>9,10</i>	74	4,124
Income tax payable		156	78
Total Current Liabilities		115,190	66,073
Noncurrent Liabilities			
Long-term debt - net of current portion	<i>9,10</i>	45,337	45,744
Retirement benefits liability		1,503	671
Deferred tax liabilities		3,347	1,819
Asset retirement obligation		1,059	1,061
Other noncurrent liabilities	<i>9,10</i>	715	740
Total Noncurrent Liabilities		51,961	50,035
Equity Attributable to Equity Holders of the Parent Company			
Capital stock		9,475	9,475
Additional paid-in capital		9,764	9,764
Retained earnings		39,369	40,088
Other reserves		(919)	70
Total Equity Attributable to Equity Holders of the Parent Company		57,689	59,397
Non-controlling interests		17,254	290
Total Equity		74,943	59,687
		P 242,094	P 175,795

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

Certified by: 
EFREN P. ABRILLO
 Vice President/Controller




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

	Note	April to June		January to June	
		2012	2011	2012	2011
SALES	2 P	118,644	P 70,847	P 193,299	P 134,897
COST OF GOODS SOLD		116,083	65,508	184,327	121,037
GROSS PROFIT		2,561	5,339	8,972	13,860
SELLING AND ADMINISTRATIVE EXPENSES		(2,780)	(1,344)	(4,573)	(2,869)
INTEREST INCOME		309	324	649	699
INTEREST EXPENSE AND OTHER FINANCING CHARGES		(2,564)	(1,304)	(4,080)	(2,623)
SHARE IN NET INCOME (LOSS) OF ASSOCIATES		(43)	(51)	22	(103)
OTHER INCOME (CHARGES) - net		(276)	499	(331)	(913)
INCOME (LOSS) BEFORE INCOME TAX		(2,793)	3,463	659	8,051
INCOME TAX EXPENSE (BENEFIT)		(736)	852	227	2,006
NET INCOME (LOSS)	P	(2,057)	P 2,611	P 432	P 6,045
Attributable to:					
Equity Holders of the Parent Company	6 P	(1,792)	2,605	P 695	P 6,030
Non-controlling Interests		(265)	6	(263)	15
	P	(2,057)	P 2,611	P 432	P 6,045
BASIC DILUTED EARNINGS (LOSS) PER COMMON SHARE					
ATTRIBUTABLE TO EQUITY HOLDERS					
OF THE PARENT COMPANY	6 P	(0.19)	P 0.25	P 0.02	P 0.59

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

Certified by:


EFREN P. GABRILLO
 Vice President Controller



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

	April to June		January to June	
	2012	2011	2012	2011
NET INCOME (LOSS)	P (2,057)	P 2,611	P 432	P 6,045
NET GAIN (LOSS) ON AVAILABLE-FOR-SALE FINANCIAL ASSETS - NET OF TAX	(3)	88	(8)	(1)
EXCHANGE DIFFERENCES ON TRANSLATION OF FOREIGN OPERATIONS	(1,107)	(11)	(981)	6
OTHER COMPREHENSIVE INCOME (LOSS) - NET OF TAX	(1,110)	77	(989)	5
TOTAL COMPREHENSIVE INCOME (LOSS)	P (3,167)	P 2,688	P (557)	P 6,050
Comprehensive Income (Loss) Attributable to:				
Equity holders of the Parent Company	P (2,902)	P 2,682	P (294)	P 6,035
Non-controlling Interests	(265)	6	(263)	15
	P (3,167)	P 2,688	P (557)	P 6,050

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

Certified by:


EFREN L. FABRILLO
Vice President Controller

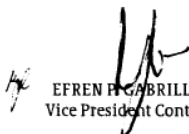


PETRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
FOR THE PERIOD ENDED JUNE 30, 2012 AND 2011
 (Amounts in Million Pesos)

	Equity Attributable to Equity Holders of the Parent Company																		
	Preferred Stock		Common Stock		Additional paid-in capital		Retained Earnings		Other Reserves		Non-controlling Interest		Total Equity						
	P	100	P	9,375	P	9,764	P	25,171	P	14,917	P	70	P	59,397	P	290	P	59,687	
Balance at January 1, 2012 (Audited)																			
Total comprehensive income										695		(989)		(294)		(263)		(557)	
Cash dividends (Note 7)										(1,414)				(1,414)				(1,414)	
Net additions to non-controlling interests and others														-		17,227		17,227	
Balance at June 30, 2012 (Unaudited)	P	100	P	9,375	P	9,764	P	25,171	P	14,198	(P	919)	P	57,689	P	17,254	P	74,943	
Balance at January 1, 2011 (Audited)	P	100	P	9,375	P	9,764	P	15,543	P	18,205	P	83	P	53,070	P	274	P	53,344	
Total comprehensive income										6,030		5		6,035		15		6,050	
Appropriation for capital projects								9,628		(9,628)				-				-	
Cash dividends (Note 7)										(1,414)				(1,414)				(1,414)	
Balance at June 30, 2011 (Unaudited)	P	100	P	9,375	P	9,764	P	25,171	P	13,193	P	88	P	57,691	P	289	P	57,980	

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

Certified by:


EFREN P. G. BRILLO
 Vice President Controller



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

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before income tax	P 659	P 8,051
Adjustments for:		
Share in net (gain) loss of an associate	(22)	103
Depreciation and amortization	2,284	1,749
Interest expense	4,080	2,623
Interest income	(649)	(699)
Net unrealized foreign exchange gain	(587)	(63)
Others	(311)	(40)
Operating income before working capital changes	5,454	11,724
Changes in operating assets and liabilities		
Increase in assets:		
Receivables	(2,738)	(1,029)
Inventories	(8,904)	(13,562)
Other current assets	(7,610)	(2,405)
Increase (decrease) in liabilities:		
Liabilities for crude oil and petroleum product importation	832	5,778
Accounts payable and accrued expenses and others	(2,745)	175
Provisions for doubtful accounts, inventory obsolescence and others	45	36
Interest paid	(3,696)	(2,771)
Income taxes paid	(346)	(267)
Interest received	690	730
Net cash flows used in operating activities	(19,018)	(1,591)
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to:		
Property, plant and equipment	(12,682)	(6,426)
Decrease (increase) in:		
Other receivables	1,909	649
Other noncurrent assets	11,166	(337)
Reductions from (additions to):		
Financial assets at fair value through profit or loss	(25)	30
Available-for-sale investments	105	(25)
Acquisition of subsidiaries, net of cash and cash equivalents acquired	(18,969)	-
Investments	727	(1,266)
Net cash flows used in investing activities	(17,769)	(7,375)
CASH FLOWS FROM FINANCING ACTIVITIES		
Availment of loans	149,806	29,490
Payments of:		
Loans	(132,710)	(40,612)
Cash dividends	(1,392)	(1,394)
Issuance of Preferred Share by a subsidiary	14,216	-
Others	(26)	73
Net cash flows provided by (used in) financing activities	29,894	(12,443)
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(48)	(23)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,941)	(21,432)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	23,823	43,984
CASH AND CASH EQUIVALENTS AT END OF PERIOD	P 16,882	P 22,552

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

Certified by:


EFREN L. CABRILLO
Vice President Controller

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

1. Summary of Significant Accounting and Financial Reporting Policies

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

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

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

Adoption of New Standards, Amendments to Standards and Interpretations

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

Amendments to Standards and Interpretations Adopted in 2012

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

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

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

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

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

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

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

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

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

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

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

2. Segment Information

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

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

- a. Sales of petroleum and other related products which include gasoline, diesel and kerosene offered to motorists and public transport operators through its service station network around the country.
- b. Insurance premiums from the business and operation of all kinds of insurance and reinsurance, on sea as well as on land, of properties, goods and merchandise, of transportation or conveyance, against fire, earthquake, marine perils, accidents and all other forms and lines of insurance authorized by law, except life insurance.

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

Segment Assets and Liabilities

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

Inter-segment Transactions

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

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

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
<u>Period Ended June 30,</u>						
<u>2012</u>						
Revenue						
External Sales	P192,133	P -	P -	P1,166	P -	P193,299
Inter-segment Sales	104,593	59	182	-	(104,834)	-
Segment results	4,140	46	72	45	97	4,400
Net income	718	81	13	52	(432)	432
<u>As of June 30, 2012</u>						
Assets and liabilities						
Segment assets	263,118	2,101	4,429	1,144	(28,790)	242,002
Segment liabilities	174,870	751	3,480	408	(15,705)	163,804
Other segment information						
Property, plant and equipment	71,573	-	-	234	4,164	75,971
Depreciation and amortization	2,267	-	-	17	-	2,284

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
<u>Period Ended June 30, 2011</u>						
Revenue						
External Sales	P134,017	P -	P -	P880	P -	P134,897
Inter-segment Sales	107,424	59	174	-	(107,657)	-
Segment results	10,461	43	77	44	163	10,788
Net income	6,104	79	25	52	(215)	6,045
<u>As of Dec. 31, 2011</u>						
Assets and liabilities						
Segment assets	183,449	1,834	3,954	918	(14,375)	175,780
Segment liabilities	124,123	146	3,018	224	(13,222)	114,289
Other segment information						
Property, plant and equipment	46,465	-	-	205	3,776	50,446
Depreciation and amortization	3,615	-	-	42	-	3,657

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

	Retail	Lube	Gasul	Industrial	Others	Total
<u>Property, plant and equipment</u>						
As of June 30, 2012	P16,832	P250	P278	P83	P54,130	P71,573
As of December 31, 2011	5,189	279	205	78	44,695	50,446
<u>Capital Expenditures</u>						
As of June 30, 2012	P822	P-	P109	P14	P29,559	P30,504
As of December 31, 2011	303	-	11	-	17,854	18,168
<u>Revenue</u>						
Period ended June 30, 2012	P57,427	P1,467	P10,469	P59,800	P63,761	P192,924
Period ended June 30, 2011	53,114	1,191	9,685	51,235	19,317	134,542

Geographical Segments

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

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
<u>Period ended June 30, 2012</u>						
Revenue						
Local	P135,067	P33	P182	P1,166	(P1,418)	P135,030
Export/International	161,659	26	-	-	(103,416)	58,269

	Petroleum	Insurance	Leasing	Marketing	Elimination	Total
<u>Period ended June 30, 2011</u>						
Revenue						
Local	P118,845	P38	P174	P880	(P1,209)	P118,728
Export/International	122,596	21	-	-	(106,448)	16,169

3. Related Party Transactions

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

Transactions with Current Owners/Related Parties

- a. Sales relate to the Parent Company's supply agreements with various subsidiaries of San Miguel Corporation (SMC). Under these agreements, the Parent Company supplies the bunker, diesel fuel and lube requirements of selected SMC plants and subsidiaries.
- b. Purchases relate to purchase of goods and services such as construction, information technology and shipping.
- c. Petron entered into lease agreement with San Miguel Properties, Inc. (SMPI) for its office space covering 6,759 square meters with a monthly rate of P3.9. The lease, which commenced on June 1, 2011, is for a period of one year and may be renewed for a period in accordance with the written agreement of the parties. The agreement is in the process of renewal as of June 30, 2012.
- d. The Parent Company also pays SMC for its share in common expenses such as utilities and administrative fees.
- e. The Parent Company advanced certain monies to the Petron Corporation Employees' Retirement Plan (PCERP) for some investment opportunities.

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

June 30, 2012

Related Parties	Relationship With Related Parties	Revenue from Related Parties	Purchases from Related Parties	Amounts Owed by Related Parties	Amounts Owed to Related Parties
SMC	Ultimate Parent	P1	P76	P1	P16
San Miguel Brewery Inc.	Under common control	513	140	106	21
San Miguel Yamamura Packaging Corporation	Under common control	393	-	83	-
SMC Shipping & Lighterage Corporation	Under common control	247	858	44	43
Ginebra San Miguel, Inc. and Subsidiaries	Under common control	P254	P13	P56	P-
San Miguel Energy Corporation	Under common control	64	603	-	53
San Miguel Yamamura Asia Corporation	Under common control	408	-	89	-
Challenger Aero Air Corporation	Under common control	10	-	7	-
Mindanao Corrugated Fibreboard, Inc.	Under common control	31	-	4	-
San Miguel Purefoods Co, Inc. and Subsidiaries	Under common control	255	2	92	-
Archen Technologies, Inc.	Under common control	2	343	1	109
SMPI	Under common control	-	-	79	376
Others	Under common control	-	81	16	40
		P2,178	P2,116	P578	P658

December 31, 2011

Related Parties	Relationship With Related Parties	Revenue from Related Parties	Purchases from Related Parties	Amounts Owed by Related Parties	Amounts Owed to Related Parties
SMC	Ultimate Parent	P1	P76	P -	P20
Pan Asia Energy Holdings Inc.	Under common control	577	-	-	-
San Miguel Brewery Inc.	Under common control	934	140	111	19
San Miguel Yamamura Packaging Corporation	Under common control	708	-	96	-
SMC Shipping & Lighterage Corporation	Under common control	420	858	41	32
Ginebra San Miguel, Inc. and Subsidiaries	Under common control	P674	P13	P147	P4
San Miguel Energy Corporation	Under common control	146	603	33	52
San Miguel Yamamura Asia Corporation	Under common control	775	-	83	-
Challenger Aero Air Corporation	Under common control	30	-	16	-
Mindanao Corrugated Fibreboard, Inc.	Under common control	43	-	9	-
San Miguel Purefoods Co., Inc. and Subsidiaries	Under common control	484	2	90	5
Archen Technologies, Inc.	Under common control	12	343	-	130
SMPI	Under common control	-	418	95	367
Others	Under common control	37	90	24	23
		P4,841	P2,543	P745	P652

4. Property, Plant and Equipment

This account consists of:

	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
Cost:							
December 31, 2010	P13,871	P37,292	P5,353	P2,145	P4,526	P2,796	P65,983
Additions	555	524	831	1,002	526	17,904	21,342
Disposals/reclassifications	(251)	(6)	(115)	(77)	473	(2,532)	(2,508)
December 31, 2011	14,175	37,810	6,069	3,070	5,525	18,168	84,817
Additions	151	2	508	385	388	12,290	13,724
Disposals/reclassifications/ acquisition of a subsidiary	7,594	10,905	6,805	748	3,656	260	29,968
	7,745	10,907	7,313	1,133	4,044	12,550	43,692
June 30, 2012	21,920	48,717	13,382	4,203	9,569	30,718	128,509
Accumulated depreciation and amortization:							
December 31, 2010	7,621	16,552	3,756	1,728	1,369	-	31,026
Additions	721	2,027	504	219	93	-	3,564
Disposals/reclassifications	(113)	(1)	(38)	(67)	-	-	(219)
December 31, 2011	8,229	18,578	4,222	1,880	1,462	-	34,371
Additions	480	1,042	422	183	31	-	2,158
Disposals/reclassifications/ acquisition of a subsidiary	4,143	7,632	4,032	655	(10)	-	16,452
Currency translation adjustment	(112)	(203)	(110)	(18)	-	-	(443)
June 30, 2012	12,740	27,049	8,566	2,700	1,483	-	52,538
Net book value:							
December 31, 2011	P5,946	P19,232	P1,847	P1,190	P4,063	P18,168	P50,446
June 30, 2012	P9,180	P21,668	P4,816	P1,503	P8,086	P30,718	P75,971

Capital Commitments

As of June 30, 2012 and December 31, 2011, the Group has outstanding commitments to acquire property, plant and equipment amounting to P3,439 and P4,278, respectively.

5. Significant Agreements

Lease Agreement

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

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

Fuel Supply Contract

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

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

NPC

Bid Date	Date of Award	Contract Duration	DFO* (in KL*)	IFO* (in KL)	DFO Total Contract Price (Php)	IFO Total Contract Price (Php)
December 29, 2011	January 11, 2012	January- December 2012 (Calayan DP & others)	39,000	21,335	1,681,957,320	758,250,650
December 29, 2011	February 29, 2012	January-December 2012 (Calapan Modular and Jolo)	23,708		1,032,456,775	

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

PSALM

Bid Date	Date of Award	Contract Duration	DFO* (in KL*)	IFO* (in KL)	DFO Total Contract Price (Php)	IFO Total Contract Price (Php)
January 12, 2011	January 31, 2011	Power Barge 101 January- December 2011 (with 6 months extension)		14,426		364,821,999
January 12, 2011	January 31, 2011	Power Barge 102 January- December 2011 (with 6 months extension)		16,525		417,904,030
January 12, 2011	January 31, 2011	Power Barge 103 January- December 2011 (with 6 months extension)		13,636		344,690,808
January 12, 2011	January 31, 2011	Malaya Thermal Power Plant January- December 2011 (with 6 months extension)	1,400		45,090,780	
January 12, 2011	January 31, 2011	Naga Plant Complex January- December 2011 (with 6 months extension)	1,603		51,628,943	
January 12, 2011	January 31, 2011	Power Barge 101 January- December 2011 (with 6 months extension)	2,246		72,092,782	
January 12, 2011	January 31, 2011	Power Barge 102 January- December 2011 (with 6 months extension)	3,085		99,023,256	

(Forward)

Bid Date	Date of Award	Contract Duration	DFO* (in KL*)	IFO* (in KL)	DFO Total Contract Price (Php)	IFO Total Contract Price (Php)
January 12, 2011	January 31, 2011	Power Barge 103 January- December 2011 (with 6 months extension)	3,309		108,371,735	
January 12, 2011	January 31, 2011	Power Barge 104 January- December 2011 (with 6 months extension)	3,226		102,898,754	
January 12, 2011	January 31, 2011	Southern Power Philippines Corporation January- December 2011 (with 6 months extension)	173		5,747,856	
January 12, 2011	January 31, 2011	Western Mindanao Power Corporation January- December 2011 (with 6 months extension)	150		4,919,565	
February 21, 2012	March 9, 2012	Power Barge 101 March- December 2012		5,950		205,446,955
February 21, 2012	March 9, 2012	Power Barge 102 March- December 2012		6,830		235,832,387
February 21, 2012	March 9, 2012	Power Barge 103 March- December 2012		5,960		207,663,088
February 21, 2012	March 9, 2012	Power Barge 104 March- December 2012		18,550		643,263,915
February 21, 2012	March 9, 2012	Southern Power Philippines Corporation March- December 2012		55,600		1,906,763,080
May 28, 2012	June 20, 2012	Naga TPP Complex June- December 2012	570		25,333,935.00	
May 28, 2012	June 20, 2012	Power Barge 101 June- December 2012	360		15,982,740.00	
May 28, 2012	June 20, 2012	Power Barge 102 June- December 2012	480		21,310,320.00	
May 28, 2012	June 20, 2012	Power Barge 103 June- December 2012	480		21,868,656.00	
May 28, 2012	June 20, 2012	Power Barge 104 June- December 2012	830		36,332,669.00	
May 28, 2012	June 20, 2012	Western Mindanao Power Corporation June- December 2012	60		2,707,674.00	

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

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

6. Earnings Per Share

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

	2012	2011
Net income attributable to equity holders of the Parent Company	P695	P6,030
Dividends on preferred shares for the period	476	476
Net income attributable to common shareholders of Parent Company	P219	P5,554
Weighted average number of common shares outstanding (in millions)	9,375	9,375
Basic/diluted earnings per common share	P0.02	P0.59

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

7. Dividends

On March 7, 2012, the Board of Directors (BOD) approved cash dividends of P2.382 per share to preferred shareholders for the second and third quarters of 2012 with payment dates on June 5, 2012 and September 5, 2012, respectively. On the same date, a cash dividend of P0.10 per share was approved by the BOD for common shareholders as of record date April 2, 2012 which was paid on April 24, 2012.

8. Commitments and Contingencies

Unused Letters of Credit and Outstanding Standby Letters of Credit

Petron has unused letters of credit totaling approximately P34,817 and P25,452 as of June 30, 2012 and December 31, 2011, respectively.

Tax Credit Certificates-Related Matters

In 1998, the Bureau of Internal Revenue (BIR) issued a deficiency excise tax assessment against the Parent Company relating to the Parent Company's use of P659 worth of Tax Credit Certificates (TCCs) to pay certain excise tax obligations from 1993 to 1997. The TCCs were transferred to the Parent Company by suppliers as payment for fuel purchases. The Parent Company contested the BIR's assessment before the Court of Tax Appeals (CTA). In July 1999, the CTA ruled that, as a fuel supplier of Board of Investments-(BOI) registered companies, the Parent Company was a qualified transferee of the TCCs and that the collection by the BIR of the alleged deficiency excise taxes was contrary to law. On March 21, 2012, the Court of Appeals

promulgated a decision in favor of the Parent Company and against the BIR affirming the ruling of the CTA striking down the assessment issued by the BIR for deficiency excise taxes in 1998 based on a finding by the BIR that the TCCs used by the Parent Company as payment were fraudulent.

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

There are duplications in the TCCs subject of the assessments described above. Excluding these duplications, the aggregate deficiency excise taxes, excluding interest and penalties, resulting from the cancellation of the subject TCCs amounted to P911.

Pandacan Terminal Operations

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

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

However, on March 7, 2007, in the case filed by SJS, the Supreme Court rendered a decision (March 7 Decision) directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, the Parent Company, together with Shell and Chevron, filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision, on the ground that the Supreme Court failed to consider supervening events, notably (i) the passage of Ordinance 8119 which superseded Ordinance 8027 and (ii) the RTC orders preventing the implementation of Ordinance 8027. The Parent Company, Shell, and Chevron also noted the possible ill-effects on the entire country arising from the sudden closure of the oil terminals in Pandacan.

On February 13, 2008, the Supreme Court resolved to allow the Parent Company, Shell and Chevron to intervene, but denied their motion for reconsideration. In its February 13 resolution (February 13 Resolution), the Supreme Court also declared Ordinance 8027 valid, dissolved all existing injunctions against the implementation of the Ordinance 8027, and directed the Parent Company, Shell and Chevron to submit their relocation plans to the RTC. The Parent Company, Shell and Chevron have sought reconsideration of the February 13 Resolution. In compliance with the February 13 Resolution, the Parent Company, Shell and Chevron submitted their comprehensive relocation plans to the RTC.

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

In June 2009, petitions were filed with the Supreme Court, seeking the nullification of Ordinance 8187 and enjoining its implementation. The Parent Company filed a manifestation on November 30, 2010 informing the Supreme Court that, without prejudice to its position in the cases, it had decided to cease operation of its petroleum product storage facilities in Pandacan within 5 years or not later than January 2016 due to the many unfounded environmental issues being raised that tarnish the image of the Parent Company and the various amendments being made to the zoning ordinances of the City of Manila when the composition of the local government changes, resulting in litigation involving such amended zoning ordinances. In a letter dated July 6, 2012 (with copies to the offices of the Vice Mayor and the City Council of Manila), the Parent Company reiterated its commitment to cease the operation of its petroleum product storage facilities and transfer them to another location by January 2016.

Guimaras Oil Spill Incident

On August 11, 2006, MT Solar I, a third party vessel contracted by the Parent Company to transport approximately two million liters of industrial fuel oil, sunk 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the Philippine Department of Justice (DOJ) and the Special Board of Marine Inquiry (SBMI), both agencies found the owners of MT Solar I liable. The DOJ found the Parent Company not criminally liable, but the SBMI found the Parent Company to have overloaded the vessel. The Parent Company has appealed the findings of the SBMI to the Philippine Department of Transportation and Communication (DOTC) and is awaiting its resolution. The Parent

Company believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as the Parent Company, which are charterers.

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

Another complaint for non-payment of compensation for the clean-up operations during the oil spill was filed on August 6, 2009 by a total of 1,063 plaintiffs who allegedly did not receive any payment of their claims for damages arising from the oil spill. The total claims for both cases amount to P292.

9. Financial Risk Management Objectives and Policies

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

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

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

Risk Management Structure

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

The Group's risk management process is a bottom-up approach, with each risk owner mandated to conduct regular assessment of its risk profile and formulate action plans for managing identified risks. As the Group's operation is an integrated value chain, risks emanate from every

process, while some could cut across groups. The results of these activities flow up to the Management Committee and, eventually, the BOD through the Group's annual business planning process.

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

1. The Risk and Insurance Management Group, which is mandated with the overall coordination and development of the enterprise-wide risk management process.
2. The Financial Risk Management Unit of the Treasurer's Department, which is in charge of foreign exchange hedging transactions.
3. The Transaction Management Unit of Controllers Department, which provides backroom support for all hedging transactions.
4. The Corporate Technical & Engineering Services Group, which oversees strict adherence to safety and environmental mandates across all facilities.
5. The Internal Audit Department, which has been tasked with the implementation of a risk-based auditing.
6. PSTPL executes the hedging transactions involving crude and product imports on behalf of the Group.

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

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

Foreign Currency Risk

The Group's functional currency is the Philippine peso, which is the denomination of the bulk of the Group's revenues. The Group's exposures to foreign exchange risk arise mainly from United

States (US) dollar-denominated sales as well as purchases principally of crude oil and petroleum products. As a result of this, the Group maintains a level of US dollar-denominated assets and liabilities during the period. Foreign exchange risk occurs due to differences in the levels of US dollar-denominated assets and liabilities.

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

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

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

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

	June 30, 2012		December 31, 2011	
	US Dollar	Peso Equivalent	US Dollar	Peso Equivalent
Assets				
Cash and cash equivalents	198	8,340	338	14,818
Trade and other receivables	653	27,504	343	15,037
Other assets	36	1,516	29	1,271
	887	37,360	710	31,126
Liabilities				
Short-term loans	442	18,617	-	-
Liabilities for crude oil and petroleum product importation	1,059	44,605	509	22,314
Long-term debt (including current maturities)	300	12,636	356	15,607
Other liabilities	45	1,895	7	307
	1,846	77,753	872	38,228
Net foreign currency-denominated monetary liabilities	(959)	(40,393)	(162)	(7,102)

The Group reported net foreign exchange gains amounting to P282 and P172 for the period ending June 30, 2012 and June 30, 2011, respectively, with the translation of its foreign currency-denominated assets and liabilities. These mainly resulted from the movements of the Philippine peso against the US dollar as shown in the following table:

	Peso to US Dollar
June 30, 2011	43.33
December 31, 2011	43.84
June 30, 2012	42.12

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

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

	P1 decrease in the US\$ exchange rate		P1 increase in the US\$ exchange rate	
	Effect on Income before Income Tax	Effect on Equity	Effect on Income before Income Tax	Effect on Equity
June 30, 2012				
Cash and cash equivalents	(112)	(165)	112	165
Trade and other receivables	(49)	(638)	49	638
Other assets	(14)	(32)	14	32
	(175)	(835)	175	835
Short-term loans	67	422	(67)	(422)
Liabilities for crude oil and petroleum product importation	424	932	(424)	(932)
Long-term debt (including current maturities)	300	210	(300)	(210)
Other liabilities	15	41	(15)	(41)
	806	1,605	(806)	(1,605)
	631	770	(631)	(770)

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

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

Interest Rate Risk

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

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

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

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

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

The sensitivity to a reasonably possible 1% increase in the interest rates, with all other variables held constant, would have decreased the Group's profit before tax (through the impact on floating rate borrowings) by P126 and P168 in the period ending June 30, 2012 and December 31, 2011, respectively. A 1% decrease in the interest rate would have had the equal but opposite effect. There is no impact on the Group's other income.

Interest Rate Risk Table

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

June 30, 2012	<1 year	1-<2 years	2-<3 years	3-<4 years	4-<5 years	>5 years	Total
Fixed rate							
Philippine peso denominated	P84	P5,284	P84	P4,548	P36	P23,420	P33,456
Interest rate	6.3% - 9.3%	6.3% - 9.3%	6.3% - 9.3%	6.3% - 9.3%	6.3% - 7.2%	6.3% - 7.0%	
US\$ denominated (expressed in Php)	-	-	3,972	5,776	2,888	-	12,636
Interest rate*			1, 3, 6 mos. Libor + margin	1, 3, 6 mos. Libor + margin	1, 3, 6 mos. Libor + margin		
	P84	P5,284	P4,056	P10,324	P2,924	P23,420	P46,092

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

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

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

Credit Risk

Credit Risk is the risk of financial loss to the Group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. In effectively managing credit risk, the Group regulates and extends credit only to qualified and credit-worthy customers and counterparties, consistent with established Group credit policies, guidelines and credit verification procedures. Request for credit facilities from trade customers undergo stages of review by Sales and Finance Divisions. 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. Generally, the maximum credit risk exposure of financial assets is the total carrying amount of the financial assets as shown on the face of the consolidated statements of financial position or in the notes to the consolidated financial statements, as summarized below:

	June 30, 2012	December 31, 2011
Cash in bank and cash equivalents	P12,815	P19,528
Derivative assets	67	43
Trade and other receivables-net	40,042	26,605
Due from related parties	12,038	23,787
Long-term receivables	396	88
	P65,358	P70,051

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

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

Collaterals. To the extent practicable, the Group also requires collateral as security for a credit facility to mitigate risk in trade receivables. Among the collaterals held are letters of credit, bank guarantees, real estate mortgages, and cash bonds valued at P3,745 and P3,925 as of June 30, 2012 and December 31, 2011, respectively. These securities may only be called on or applied upon default of customers.

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

Credit Quality. In monitoring and controlling credit extended to counterparty, the Group adopts a comprehensive credit rating system based on financial and non-financial assessments of its customers. Financial factors being considered comprised of the financial standing of the customer

while the non-financial aspects include but are not limited to the assessment of the customer's nature of the business, management profile, industry background, payment habit and both present and potential business dealings with the Group.

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

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

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

Liquidity Risk

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

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

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

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

June 30, 2012	Carrying Amount	Contractual Cash Flow	1year or less	>1 year - 2 years	>2 year - 5 years	Over 5 years
Financial assets						
Cash and cash equivalents	P16,882	P16,882	P16,882	P-	P-	P-
Trade and other receivables	40,042	40,042	40,042	-	-	-
Due from related parties	12,038	12,065	131	11,652	282	-
Derivative assets	67	67	67	-	-	-
Financial assets at FVPL	227	227	227	-	-	-
AFS financial assets	931	954	118	182	654	-
Long-term receivables	396	408	10	337	30	31

(Forward)

June 30, 2012	Carrying Amount	Contractual Cash Flow	1year or less	>1 year - 2 years	>2 year - 5 years	Over 5 years
Financial liabilities						
Short-term loans	75,554	76,009	76,009	-	-	-
Liabilities for crude oil and petroleum product importation	31,145	31,145	31,145	-	-	-
Accounts payable and accrued expenses (excluding taxes payable)	7,520	7,520	7,520	-	-	-
Derivative liabilities	55	55	55	-	-	-
Long-term debt (including current maturities)	45,411	60,860	3,281	8,354	24,178	25,047
Cash bonds	332	337	277	10	11	39
Cylinder deposits	215	215	-	-	-	215
Other noncurrent liabilities	47	47	-	-	25	22

December 31, 2011	Carrying Amount	Contractual Cash Flow	1year or less	>1 year - 2 years	>2 year - 5 years	Over 5 Years
Financial assets						
Cash and cash equivalents	P23,823	P23,823	P23,823	P-	P-	P-
Trade and other receivables	26,605	26,610	26,610	-	-	-
Due from related parties	23,787	24,337	1,610	22,346	381	-
Derivative assets	43	43	43	-	-	-
Financial assets at FVPL	194	194	194	-	-	-
AFS financial assets	1,036	1,107	93	117	897	-
Long-term receivables	88	99	7	25	39	28
Financial liabilities						
Short-term loans	40,593	40,877	40,877	-	-	-
Liabilities for crude oil and petroleum product importation	13,842	13,842	13,842	-	-	-
Accounts payable and accrued expenses (excluding taxes payable)	6,600	6,600	6,600	-	-	-
Derivative liabilities	55	55	55	-	-	-
Long-term debts (including current maturities)	49,868	67,242	7,621	9,038	24,076	26,237
Cash bonds	303	312	257	11	15	29
Cylinder deposits	383	383	-	-	-	383
Other noncurrent liabilities	54	54	-	1	32	21

Commodity Price Risk

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

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

Other Market Price Risk

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

Capital Management

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

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

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

	June 30, 2012	December 31, 2011
Total assets	P242,094	P175,795
Total liabilities	167,151	116,108
Total equity	74,943	59,687
Debt to equity ratio	2.2:1	1.9:1

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

10. Financial Assets and Financial Liabilities

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

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

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

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

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

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

Financial Assets

Financial Assets at FVPL. A financial asset is classified at FVPL if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at FVPL

if the Group manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Group's documented risk management or investment strategy. Derivative instruments (including embedded derivatives), except those covered by hedge accounting relationships, are classified under this category.

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

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

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

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

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

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

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

The carrying values of financial assets under this category amounted to P294 and P237 as of June 30, 2012 and December 31, 2011, respectively.

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

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

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

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

The combined carrying values of financial assets under this category amounted to P69,358 and P74,303 as of June 30, 2012 and December 31, 2011, respectively.

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

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

AFS Financial Assets. AFS financial assets are non-derivative financial assets that are either designated in this category or not classified in any of the other financial asset categories. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses and foreign currency differences on AFS debt instruments, are recognized in other comprehensive income and presented in the “Other reserves” in equity. The effective yield component of AFS debt securities, as well as the impact of restatement on foreign currency-

denominated AFS investment securities, is reported as part of “Interest income” in the consolidated statements of income. The unrealized gains and losses arising from the changes in fair value of AFS financial assets, net of tax, are excluded from profit and loss and are recognized as other comprehensive income reported in the consolidated statements of comprehensive income and in the consolidated statements of changes in equity under “Other Reserves” account. Any interest earned on AFS debt securities shall be recognized as part of “Interest income” in the consolidated statements of income on an accrual basis. Dividends earned on holding AFS equity securities are recognized as “Dividend income” when the right of collection has been established. When individual AFS financial assets are either derecognized or impaired, the related accumulated unrealized gains or losses previously reported in equity are transferred to and recognized in profit or loss.

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

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

The carrying values of financial assets under this category amounted to P931 and P1,036 as of June 30, 2012 and December 31, 2011, respectively.

Financial Liabilities

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

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

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

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

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

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

The combined carrying values of financial liabilities under this category amounted to P160,224 and P111,643 as of June 30, 2012 and December 31, 2011, respectively.

Debt Issue Costs

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

Embedded Derivatives

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

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

Derecognition of Financial Assets and Financial Liabilities

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

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

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

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

Impairment of Financial Assets

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

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

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

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

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

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

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

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

Classification of Financial Instruments Between Debt and Equity

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

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

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

Offsetting Financial Instruments

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

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

	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Financial assets (FA):				
Cash and cash equivalents	P16,882	P16,882	P23,823	P23,823
Trade and other receivables	40,042	40,042	26,605	26,605
Due from related parties	12,038	12,038	23,787	23,787
Long-term receivables	396	396	88	88
Loans and receivables	69,358	69,358	74,303	74,303
AFS financial assets	931	931	1,036	1,036
Financial assets at FVPL	227	227	P194	P194
Derivative assets	67	67	43	43
FA at FVPL	294	294	237	237
Total financial assets	P70,583	P70,583	P75,576	P75,576
Financial liabilities (FL):				
Short-term loans	P75,554	P75,554	P40,593	P40,593
Liabilities for crude oil and petroleum product importation	31,145	31,145	13,842	13,842
Trade and other payables (excluding specific taxes and other taxes payable)	7,520	7,520	6,600	6,600
Long-term debt including current portion	45,411	45,411	49,868	49,868
Cash bonds	332	332	303	303
Cylinder deposits	215	215	383	383
Other noncurrent liabilities	47	47	54	54
FL at amortized cost	160,224	160,224	111,643	111,643
Derivative liabilities	55	55	55	55
Total financial liabilities	P160,279	P160,279	P111,698	P111,698

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

Cash and Cash Equivalents, Trade and Other Receivables and Long-term Receivables. The carrying amount of cash and cash equivalents and receivables approximates fair value primarily due to the relatively short-term maturities of these financial instruments. In the case of long-term

receivables, the fair value is based on the present value of expected future cash flows using the applicable discount rates based on current market rates of identical or similar quoted instruments.

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

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

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

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

Derivative Financial Instruments

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

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

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

Freestanding Derivatives

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

Currency Forwards

As of June 30, 2012 and December 31, 2011, the Group has outstanding foreign currency forward contracts with aggregate notional amount of US\$123 and US\$220, respectively with various maturities up to July 2012. As of June 30, 2012 and December 31, 2011, the net positive (negative) fair value of these currency forwards amounted to (P54) and P40, respectively.

Commodity Swaps

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

The outstanding equivalent notional quantities covered by the commodity swaps as of June 30, 2012 and December 31, 2011 were 0.9 million barrels and 1.8 million barrels, respectively. As of June 30, 2012 and December 31, 2011, the positive fair values of these swaps amounted to P125 and P147, respectively.

Commodity Options

The Group has outstanding commodity options covering its crude oil requirements with notional quantity of 1.3 million barrels as of June 30, 2012 and December 31, 2011. These call and put options can be exercised at various calculation dates in 2012 with specified quantities on each calculation date. The net positive (negative) fair value of these options as of June 30, 2012 and December 31, 2011 amounted to (P155) and P47, respectively.

Embedded Derivatives

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

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

Embedded Currency Forwards

As of June 30, 2012 and December 31, 2011, the total outstanding notional amount of currency forwards embedded in non-financial contracts amounted to US\$109 and US\$91, respectively. These non-financial contracts consist mainly of foreign currency-denominated service contracts, purchase orders and sales agreements. The embedded forwards are not clearly and closely related to their respective host contracts. As of June 30, 2012 and December 31, 2011, the net negative fair value of these embedded currency forwards amounted to (P66) and (P52), respectively.

For the periods ended June 30, 2012 and December 31, 2011, the Group recognized marked-to-market gains (losses) from freestanding and embedded derivatives amounting to (P438) and P205, respectively.

Fair Value Hierarchy

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

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: inputs for the asset or liability that are not based on observable market data.

June 30, 2012	Level 1	Level 2	Total
Financial Assets			
Financial assets at FVPL	P227	P-	P227
Derivative assets	-	67	67
AFS financial assets	-	931	931
Financial Liabilities			
Derivative liabilities	-	(55)	(55)
December 31, 2011			
Financial Assets			
Financial assets at FVPL	P194	P-	P194
Derivative assets	-	43	43
AFS financial assets	-	1,036	1,036
Financial Liabilities			
Derivative liabilities	-	(55)	(55)

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

11. Events After Reporting Date

In July 2012, NVRC acquired 60% of the outstanding capital stock of Mariveles Landco Corporation for US\$600,000.

On August 9, 2012, the BOD approved cash dividend of P2.382 per share for preferred shareholders for the fourth quarter 2012 and first quarter 2013 with the following record and payment dates:

<u>Period</u>	<u>Record Date</u>	<u>Payment Date</u>
Fourth Quarter 2012	November 16, 2012	December 5, 2012
First Quarter 2013	February 20, 2013	March 5, 2013

12. Other Matters

- a. On January 24, 2012, PCERP disposed 695,300,000 common shares at a price of P11.00 per share through the facilities of the Philippine Stock Exchange. PCERP engaged Credit Suisse, Standard Chartered and UBS to act as Joint Bookrunners for the transaction.
- b. On February 15, 2012 the Parent Company availed of the remaining US\$400 million of the US\$480 million term loan facility which was signed and executed on September 30, 2011.
- c. On March 14, 2012, Petron Global Limited, the offshore subsidiary of the Parent Company in the British Virgin Islands, issued 150,000,000 cumulative, non-voting, non-participating and non-convertible preferred shares series A and 200,000,000 cumulative, non-voting, non-participating and non-convertible preferred shares series B at an issue price equal to the par value of each share of US\$1.
- d. On March 30, 2012, the Parent Company's indirect offshore subsidiary, POGI, completed the acquisition of 65% of Esso Malaysia Berhad (EMB), and 100% of ExxonMobil Malaysia Sdn Bhd (EMMSB) and ExxonMobil Borneo Sdn Bhd (EMBSB) for an aggregate purchase price of US\$577.3 million. POGI also served the notice of mandatory general offer (MGO) to acquire the remaining 94,500,000 shares representing 35% of the total voting shares of EMB for RM3.59 per share from the public. The Unconditional Mandatory Take-Over Offer was closed on May 14, 2012. As a result of the MGO, POGI was able to acquire an additional 22,679,063 shares from the public and increased its interest in EMB to 73.4%.

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

- e. On April 13, 2012, the Parent Company completed the acquisition from Two San Isidro - SIAI Assets, Inc. of the latter's shares in Limay Energen Corporation.
- f. In April 2012, NVRC acquired 100% of Parkville Estate and Development Corporation and paid P60 representing deposit for future subscription in South Luzon Prime Holdings Inc.
- g. There were no unusual items as to nature and amount affecting assets, liabilities, equity, net income or cash flows, except those stated in Management's Discussion and Analysis of Financial Position and Performance.
- h. There were no seasonal aspects that had a material effect on the financial position or financial performance of the Group.
- i. There were no material off-statements of financial position transactions, arrangements, obligations (including contingent obligations), and other relationship of the Group with unconsolidated entities or other persons created during the reporting period, except for the outstanding derivative transactions entered by the Group as of and for the period ended June 30, 2012.
- j. Certain amounts in prior year have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations for any period.
- k. Known trends, demands, commitments, events or uncertainties that will have a material impact on the Group's liquidity:

Gross Domestic Product (GDP)

The domestic economy expanded robustly during the start of the year with GDP growing by 6.4% in the first quarter of 2012 from 4.9% in the same period last year. Strong growth was boosted by the upsurge of government consumption, sustained consumer spending, and recovery in exports during the quarter. After under spending in 2011, the government is accelerating expenditures and implementation of projects. Public-Private Partnership (PPP) projects stalled last year are now being rolled out and implemented this year.

91-Day Treasury-Bill Rate

Although slightly higher than the rates in 2011, 91-day T-bill rate remained low at an average of 2.0% in the first half of the year. Low interest rates were sustained in 2012 due to the sufficient liquidity in the domestic financial markets.

Peso-Dollar Exchange Rate

The Peso continued to appreciate in 2012 and averaged P42.9/\$ in the first half from P43.5/\$ in the same period last year. The continuously growing OFW remittances, rebound of exports, and higher foreign investments supported peso's strength.

Inflation

Inflation averaged 3.0% in the first half of 2012, lower than the 4.7% average in the same period last year. Increase in prices of goods such as key food items have been gradual compared to 2011. Oil prices have also been lower especially during the second quarter of the year. First half average inflation is well within the government's target inflation of 3-5% for fiscal year 2012.

Dubai price

After surging to a peak of \$124/bbl in March due to the tensions in oil producing regions Middle East and North Africa and the oil embargo against Iran, Dubai dropped to below \$100/bbl during the second quarter of the year bringing first half average at \$111.3/bbl. The slump in prices during the second quarter was caused by bleak economic prospects with deepening crisis in the Eurozone, weak economic growth in the US and Asian giants China and India, and lower oil demand growth outlook in 2012.

Industry Oil Demand

Preliminary data from DOE shows that as of March 2012, total oil industry demand (excluding lubes and greases) increased by 2.2% to 27.3 million barrels (300.4 MBD) from 26.7 million barrels (297.2 MBD) in 1Q 2011. Favorable business environment with strong economic growth, subdued inflation, growing OFW remittances, and rising vehicle sales supported growth in oil demand.

Tight Industry Competition

Competition remains stiff with the new players implementing different marketing strategies and aggressively expanding. As of YTD March 2012, the new players (based on preliminary data from DOE excluding direct imports) have collectively cornered around 24.8% of the total oil market. Collectively, the new players are leading the LPG market segment with 59.7% market share (large increase from 2011's 44% because of Shell's sale of its LPG business to new player Isla Gas).

Updates on 2012 Capital Program

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

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

Illegal Trading Practices

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

Existing or Probable Government Regulation

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

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

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

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

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

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

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

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

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

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

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

Tax Credit Certificates-Related Matters

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

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

There are duplications in the TCCs subject of the assessments described above. Excluding these duplications, the aggregate deficiency excise taxes, excluding interest and penalties, resulting from the cancellation of the subject TCCs amounted to P911.

Pandacan Terminal Operations

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

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

However, on March 7, 2007, in the case filed by SJS, the Supreme Court rendered a decision (March 7 Decision) directing the Mayor of Manila to immediately enforce Ordinance 8027. On March 12, 2007, the Parent Company, together with Shell and Chevron, filed motions with the Supreme Court seeking intervention and reconsideration of the March 7 Decision, on the ground that the Supreme Court failed to consider supervening events, notably (i) the passage of Ordinance 8119 which supersedes Ordinance 8027 and (ii) the RTC orders preventing the implementation of Ordinance 8027. The Parent Company, Shell, and Chevron also noted the possible ill-effects on the entire country arising from the sudden closure of the oil terminals in Pandacan.

On February 13, 2008, the Supreme Court resolved to allow the Parent Company, Shell and Chevron to intervene, but denied their motion for reconsideration. In its February 13 resolution (February 13 Resolution), the Supreme Court also declared Ordinance 8027 valid, dissolved all existing injunctions against the implementation of the Ordinance 8027, and directed the Parent Company, Shell and Chevron to submit their relocation plans to the RTC. The Parent Company, Shell and Chevron have sought reconsideration of the February 13 Resolution. In compliance with the February 13 Resolution, the Parent Company, Shell and Chevron submitted their comprehensive relocation plans to the RTC.

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

In June 2009, petitions were filed with the Supreme Court, seeking the nullification of Ordinance 8187 and enjoining its implementation. The Parent Company filed a manifestation on November 30, 2010 informing the Supreme Court that, without prejudice to its position in the cases, it had decided to cease operation of its petroleum product storage facilities in Pandacan within 5 years or not later than January 2016 due to the many unfounded environmental issues being raised that tarnish the image of the Parent Company and the various amendments being made to the zoning ordinances of the City of Manila when the composition of the local government changes, resulting in litigation involving such amended zoning ordinances. In a letter dated July 6, 2012 (with copies to the offices of the Vice Mayor and the City Council of Manila), the Parent Company reiterated its commitment to cease the operation of its petroleum product storage facilities and transfer them to another location by January 2016.

Guimaras Oil Spill Incident

On August 11, 2006, MT Solar I, a third party vessel contracted by the Parent Company to transport approximately two million liters of industrial fuel oil, sunk 13 nautical miles southwest of Guimaras, an island province in the Western Visayas region of the Philippines. In separate investigations by the DOJ and the SBM, both agencies found the owners of MT Solar I liable. The DOJ found the Parent Company not criminally liable, but the SBMI found the Parent Company to have overloaded the vessel. The Parent Company has appealed the

findings of the SBMI to the DOTC and is awaiting its resolution. The Parent Company believes that SBMI can impose administrative penalties on vessel owners and crew, but has no authority to penalize other parties, such as the Parent Company, which are charterers.

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

Another complaint for non-payment of compensation for the clean-up operations during the oil spill was filed on August 6, 2009 by a total of 1,063 plaintiffs who allegedly did not receive any payment of their claims for damages arising from the oil spill. The total claims for both cases amount to P292.



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

Breakdown:

Accounts Receivable - Trade	P	22,626
Accounts Receivable - Non-Trade		17,416
Total Accounts Receivable	P	40,042

AGING OF TRADE ACCOUNTS RECEIVABLES

Receivables	1-30 days	P	21,790
	31-60 days		660
	61-90 days		107
	Over 90 days		1,185
Total			23,742
Allowance for doubtful accounts			1,116
Accounts Receivable - Trade		P	22,626

Interim Financial Report as of June 30, 2012

Management's Discussion and Analysis of Financial Position and Performance

Financial Performance

2012 vs 2011

Petron Corporation (Petron) posted a consolidated net income of **₱ 432 million** for the first six months of 2012. This is significantly lower than the **₱ 6.04 billion** earnings reported during the same period last year due to the 2nd quarter losses registered by its Philippine operations (₱ 500 million) and the consolidation of Malaysian operations in the 2nd quarter (₱ 1.6 billion loss). While consolidated revenues grew by 43%, margins contracted by 35% as higher-cost inventory were sold at lower prices. The continuous drop in crude and finished product prices in the world market during the second quarter prompted the company to implement consecutive rollbacks in local pump prices.

(In Million Pesos)	2012	2011	Variance- Fav (Unfav)	
			Amt	%
Sales	193,299	134,897	58,402	43
Cost of Goods Sold	184,327	121,037	(63,290)	(52)
Gross Margin	8,972	13,860	(4,888)	(35)
Selling and Administrative Expenses	4,573	2,869	(1,704)	(59)
Non-operating Charges	3,741	2,940	(801)	(27)
Net Income	432	6,045	(5,613)	(93)
EBITDA	6,783	11,589	(4,806)	(41)
Sales Volume (MB)	32,483	23,216	9,267	40
Earnings per Share	0.02	0.59	(0.57)	(97)
Return on Sales (%)	0.2	4.5	(4.3)	(96)

With a reduced bottom line, earnings before interest, taxes, depreciation and amortization (EBITDA) of **₱ 6.78 billion** decreased by 41% from last year's **₱ 11.59 billion**.

Earnings per share stood at **₱ 0.02** from **₱ 0.59** the previous year while return on sales dropped substantially from 4.5% to **0.2%**.

Major contributory factors are the following:

Gross margin (GM) stood lower at **₱ 8.97 billion** from the **₱ 13.86 billion** level in the first half of 2011 owing largely to higher percentage increase in cost compared with the growth in revenue as discussed below:

- ◆ Sales volume for the first half of 2012 went up to **32.5 million barrels (MMB)** from previous year's **23.2 MMB** largely because of the consolidation of Petron Malaysia (8.7 MMB) in the second quarter. Moreover, sales volume in the Philippines grew by 2% (0.5 MMB) as domestic sales improved by 9% with the increase in almost all products tempered by the 37% (1.2 MMB) decline in exports.
- ◆ Net sales revenue increased by 43% to **₱ 193.30 billion** from **₱ 134.90 billion** the year before. Aside from the revenue of Petron Malaysia, sales of Petron Philippines increased brought about by the 7%

hike in average selling price per barrel (US\$142.86 in 2012 vs. US\$133.52 in 2011). The 2% growth in sales volume also contributed to higher sales revenue.

- ◆ **Cost of Goods Sold (CGS)** surged to **₱ 184.33 billion** from last year's ₱ 121.04 billion due primarily to the CGS of Petron Malaysia and the ₱ 15.67 billion increase in costs of Philippine operations prompted by the 12% escalation in cost per barrel (2012: US\$134.02 vs 2011: US\$119.80).
- ◆ **Refinery Operating Expenses** in the Philippines went up by 20% to **₱ 3.20 billion** from ₱ 2.66 billion during the same period last year. The increase emanated from maintenance and repairs of major units in the refinery, consumption of catalysts relative to the new projects, real property tax on units previously enjoying tax holiday and employee cost due to additional manpower complement.
- ◆ **Selling and Administrative Expenses** reached **₱ 4.57 billion**, up by more than half from the ₱ 2.87 billion incurred last year. Of the ₱ 1.70 billion increment, bulk came from Malaysian operations. In the Philippines, opex increased by 20% due to more aggressive advertising campaigns, depreciation of newly built service stations, donation to typhoon Sendong victims in Cagayan de Oro as well as expenses related to the acquisition of Petron Malaysia. **Opex per liter** of volume sold was higher at **₱ 0.88** this year than last year's ₱ 0.78.
- ◆ **Net Financing Costs and Other Charges** climbed to **₱ 3.74 billion** from the ₱ 2.94 billion level in the first half of 2011. The increase in average borrowing level despite lower average borrowing rate in the Philippines (2012: ₱ 101.50 billion @ 5.45% vs. 2011: ₱ 75.64 @ 5.93%) resulted in higher interest expense and bank charges. This was tempered by the significant drop in commodity hedging losses in 2012 against 2011.

2011 vs 2010

Petron posted sales revenues of **₱ 134.90 billion** in the first half of the year compared to ₱ 115.35 billion in the same period last year. The 17% growth in revenues can be largely attributed to higher oil price and increased export sales. Dubai, which is the reference crude price in the Asia Pacific region, averaged US\$105.80/barrel versus US\$77.00 in first half 2010 while export sales jumped by 54%, hitting 3.14 million barrels. Margins, likewise, improved with sales of high-margin petrochemical products of up to 1.7 million barrels during the period.

(In Million Pesos)	YTD June		Variance- Fav (Unfav)	
	2011	2010	Amt	%
Sales	134,897	115,354	19,543	17
Cost of Goods Sold	121,037	105,867	(15,170)	(14)
Gross Margin	13,860	9,487	4,373	46
Selling and Administrative Expenses	2,869	2,669	(200)	(7)
Non-operating Charges	2,940	2,961	21	1
Net Income	6,045	2,960	3,085	104
EBITDA	11,589	7,038	4,551	65
Sales Volume (MB)	23,216	23,979	(763)	(3)
Earnings per Share (In Peso)	0.59	0.29	0.30	103
Return on Sales (%)	4.5	2.6	1.9	73

Net income reached **₱ 6.05 billion** or more than double last year's profit of ₱ 2.96 billion.

With the improved bottom line, earnings before interest, taxes, depreciation and amortization (**EBITDA**) of **₱ 11.59 billion** also surpassed the **₱ 7.04 billion** level a year earlier.

Earnings per share of **₱ 0.59** was twice as much the **₱ 0.29** last year while **return on sales** grew from 2.6% to 4.5%.

Major contributory factors are the following:

Gross margin (GM) rose by 46% from **₱ 9.49 billion** in June 2010 to **₱ 13.86 billion** this year. The following accounted for the variance in gross margin:

- ◆ **Sales volume for the first half of 2011** went down to **23.2 million barrels** from previous year's 24.0 million barrels. Domestic sales dropped by 1.9 million barrels as reduced motorist activity due to high fuel prices and bad weather dampened local demand. Exports, however, grew by 54% or 1.1 million barrels.
- ◆ **Sales revenue** rose by 17% to **₱ 134.90 billion** from **₱ 115.35 billion** the year before essentially due to the escalation in average selling price per liter prompted by the 38% spike in regional MOPS prices.
- ◆ **Cost of Goods Sold (CGS)** went up to **₱ 121.04 billion** from last year's **₱ 105.87 billion** as the average cost per liter increased by 17%. The rise in cost was principally due to the 25% escalation in landed cost of crude that formed part of the total cost of goods sold.
- ◆ **Refinery Operating Expenses** increased to **₱ 2.66 billion** from **₱ 2.47 billion** during the same period last year. Higher expenses stemmed from the combined effect of the following: 1) increased power consumption due to incremental crude run and higher cost of electricity; 2) rent of equipment for Refinery Master Plan-2 project; 3) higher real property tax and 4) higher employee costs due to additional manpower complement. The increases were offset by the drop in depreciation expense.
- ◆ **Selling and Administrative Expenses (OPEX)** amounted to **₱ 2.87 billion**, 7% more than the **₱ 2.67 billion** expenditures incurred last year as newly-built service stations resulted in increased rent and depreciation. Higher acquisition of LPG cylinders and more aggressive promotional activities also contributed to the increase in OPEX. Per liter of volume sold, the average went up to **₱ 0.78** this year from **₱ 0.70** last year.
- ◆ **Net Financing Costs and Other Charges** dipped to **₱ 2.94 billion** from the **₱ 2.96 billion** level in the first half of 2010. This year's translation gain from US-dollar denominated transactions was a reversal from last year's loss. Higher interest expense due to the increase in average borrowing level and rate was tempered by interest income on advances and money placements.

Financial Position

2012 vs 2011

Petron's total resources as of June 30, 2012 stood at **₱ 242.09 billion**, 38% or **₱ 66.29 billion** higher than the end-December 2011 level of **₱ 175.80 billion** attributed largely to the consolidation of Petron Malaysia's assets.

Cash and cash equivalents dropped by 29% from **₱ 23.82 billion** to **₱ 16.88 billion**. Internally generated funds, net proceeds from loan availments, and issuance of preferred shares by Petron Global Limited as well as partial collection of advances were used to fund the acquisition of Petron Malaysia, major investments at the Refinery and working capital requirements.

Financial assets at fair value through profit or loss increased by 24% or **₱ 57 million** to **₱ 294 million** on account of higher fair value of embedded derivative instruments.

Trade and Other Receivables-net ended higher by 51% from **₱ 26.61 billion** to **₱ 40.04 billion**, traced mainly to trade and government receivables of the newly acquired subsidiary in Malaysia.

Inventories grew by 58% from **₱ 37.76 billion** to **₱ 59.83 billion** owing to Petron's higher volume of crude and price of finished products, on top of the inventories of the newly acquired subsidiary.

Other current assets of **₱ 16.35 billion** doubled up the **₱ 8.18 billion** level in December 2011 essentially due to higher input VAT and prepaid expenses of Petron Malaysia.

Property, plant and equipment-net increased by 51% (**₱ 25.52 billion**) from **₱ 50.45 billion** to **₱ 75.97 billion** attributed to the fixed assets of the newly acquired subsidiary in Malaysia and Petron's capital expenditures at the Refinery specifically the Refinery Master Plan 2 and Refinery Solid Fuel-Fired Power Plant.

Investment in associates dipped by more than half from **₱ 2.51 billion** to **₱ 1.18 billion** mainly due to the purchase by Petron of Two San Isidro - SIAI Assets, Inc.'s remaining 60% interest in Limay Energen Corporation.

Investment property-net decreased by 6% from **₱ 794 million** to **₱ 749 million** due to the depreciation of office units located in Petron MegaPlaza.

Available-for-sale financial assets declined by 10% to **₱ 931 million** brought about by lower investment in bonds of Petrogen Insurance Corporation and Overseas Ventures Insurance Corporation.

Deferred tax assets grew significantly to **₱ 92 million** from **₱ 15 million** in 2011 principally due to the assumed balance from the newly acquired subsidiary.

Goodwill of **₱ 10.09 billion** was recognized with the acquisition of Petron Malaysia.

Other noncurrent assets-net fell by 19% from **₱ 24.38 billion** to **₱ 19.68 billion** with the partial collection of advances to PCERP partly tempered by the balance of the newly acquired subsidiary in Malaysia.

Short-term loans and liabilities for crude oil and petroleum product importation rose by 96% from **₱ 54.44 billion** to **₱ 106.70 billion** owing to higher volume and price of crude and finished product importations coupled with the balances from the newly acquired subsidiary.

Trade and other payables of **₱ 8.21 billion** went up by 11% from **₱ 7.38 billion** in December 2011 traceable to the balances assumed from the newly acquired subsidiary.

Income tax payable of **₱ 156 million** was twice the end-December 2011 balance of **₱ 78 million** brought about by taxes payable of the newly acquired subsidiary.

Long-term debt inclusive of current portion slid by 9% from **₱ 49.87 billion** to **₱ 45.41 billion** due to the full settlement of the DBP, NORDB and the US\$80 million loan.

Retirement benefits liability of **₱ 1.50 billion** more than doubled the **₱ 671 million** level in December 2011 with the consolidation of balances from the newly acquired subsidiary in Malaysia.

Deferred tax liabilities surged by 84% from **₱ 1.82 billion** to **₱ 3.35 billion** due to the temporary differences of the newly acquired subsidiary.

Total equity at the end of June 2012 amounted to **₱ 74.94 billion** and recorded a 26% or **₱ 15.25 billion** improvement from the **₱ 59.69 billion** level as at end of December 2011, essentially due to the **₱ 13.95 billion** issuance of preferred shares by a subsidiary.

2011 vs 2010

Petron ended the first half of 2011 with **total resources** of **₱ 161.39 billion**, slightly lower than the end-2010 level of **₱ 161.82 billion**.

Cash and cash equivalents dropped by 49% to **₱ 22.55 billion** mainly due to the settlement of loans, investment in capital projects and purchase of inventories.

Financial assets at fair value through profit or loss went down by 14% from **₱ 227 million** to **₱ 195 million** brought about by the decline in market value of investments in marketable securities and club membership shares.

Trade and Other Receivables-net of **₱ 23.03 billion** decreased by 5% or **₱ 1.24 billion** from the **₱ 24.27 billion** level as at end of 2010 owing to lower government receivables.

Inventories grew significantly from **₱ 28.15 billion** to **₱ 41.71 billion** principally due to higher crude volume and price.

Other current assets of **₱ 6.70 billion** increased by 56% from the **₱ 4.29 billion** level in December 2010 essentially on account of higher Input VAT due to the hike in the purchase price of crude and finished products.

With the sale of the 32nd floor and 14 parking slots of Petron Mega Plaza, **assets held for sale** dwindled by 6% from **₱ 823 million** to **₱ 776 million**.

Property, plant and equipment-net increased by 14% from **₱ 34.96 billion** to **₱ 39.68 billion** attributed largely to capital expenditures at the Refinery specifically the Refinery Solid Fuel-Fired Power Plant and Refinery Master Plan 2 coupled with additional service stations.

Investment in associates went up from **₱ 804 million** to **₱ 1.39 billion** brought about mainly by the purchase of 35% interest in Manila North Harbour Port, Inc.

Deferred tax assets moved up to **₱ 129 million** from **₱ 28 million** in 2010 due to the effect of unrealized profit from subsidiaries.

Short-term loans and liabilities for crude oil and petroleum product importation decreased by 6% to **₱ 41.09 billion** due to settlements made partly tempered by higher crude importations.

Derivative Liabilities fell to **₱ 6 million** from end-December 2010's **₱ 30 million** level due to lesser notional amounts of derivative instruments.

Income tax payable ballooned from **₱ 14 million** to **₱ 586 million** due to higher taxable income during the first half of the year. The December 2010 taxable income considered the net operating loss carry-over (NOLCO) of prior years and the utilization of past years' MCIT.

Long-term debt, inclusive of current portion, ended lower by 5% from **₱ 54.40 billion** to **₱ 51.61 billion** with the payment of loan amortization.

Deferred tax liabilities amounted to **₱ 1.64 billion**, down by 16% compared with the **₱ 1.96 billion** balance as at December 31, 2010 due to the impact of temporary differences in the income tax computation.

Asset retirement obligation escalated by 6% from P 815 million to **P 861 million** on account of higher accretion rate.

Other noncurrent liabilities increased by 10% or P 59 million to **P 668 million** from P 609 million as of end-December 2010 prompted by the increases in cylinder deposits and cash bonds.

Total equity attributable to equity holders of the parent company rose by 9% to **P 57.69 billion**. The P 4.62 billion improvement in equity was principally due to the P 6.03 billion earnings realized during the first six months partly offset by cash dividends paid to preferred and common shareholders amounting to **P 1.41 billion**.

Cash Flow

Aside from lower income, the substantial increase in inventories and other current assets resulted in a net operating cash outflow of **P 19.02 billion**. Meanwhile, cash outflows from investing activities were used in the acquisition of a subsidiary in Malaysia coupled with the investments in the Refinery, augmented by the partial collection of PCERP advances. Available cash balance from the issuance of preferred shares and availment of loans was used to partly pay-off existing debts.

In Million Pesos	June 30, 2012	June 30, 2011	Change
Operating outflows	(19,018)	(1,591)	(17,427)
Investing outflows	(17,769)	(7,375)	(10,394)
Financing inflows/outflows	29,894	(12,443)	42,337

Discussion of the company's key performance indicators:

Ratio	June 30, 2012	Dec 31, 2011
Current Ratio	1.2	1.5
Debt to Equity Ratio	2.2	1.9
Return on Equity (%)	1%	15%
Tangible Net worth	P74.9B	P59.7B

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

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

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

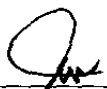
Tangible Net Worth: Net worth minus intangible assets. This figure gives a more immediately realizable value of the company.

SIGNATURES

Pursuant to the requirements of the Revised Securities Act, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Registrant: PETRON CORPORATION

Signature and Title:



JOEL ANGELO C. CRUZ
Corporate Secretary

Date: August 14, 2012

Principal Financial/Accounting Officer/Controller

Signature and Title:



EFREN P. GABRILLO
Vice President Controller

Date: August 14, 2012