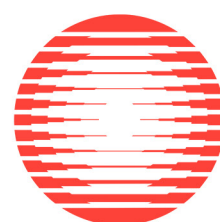


2016: PNOC in Transition

PHILIPPINE NATIONAL OIL COMPANY
2016 ANNUAL REPORT



PNOC
The Energy Company



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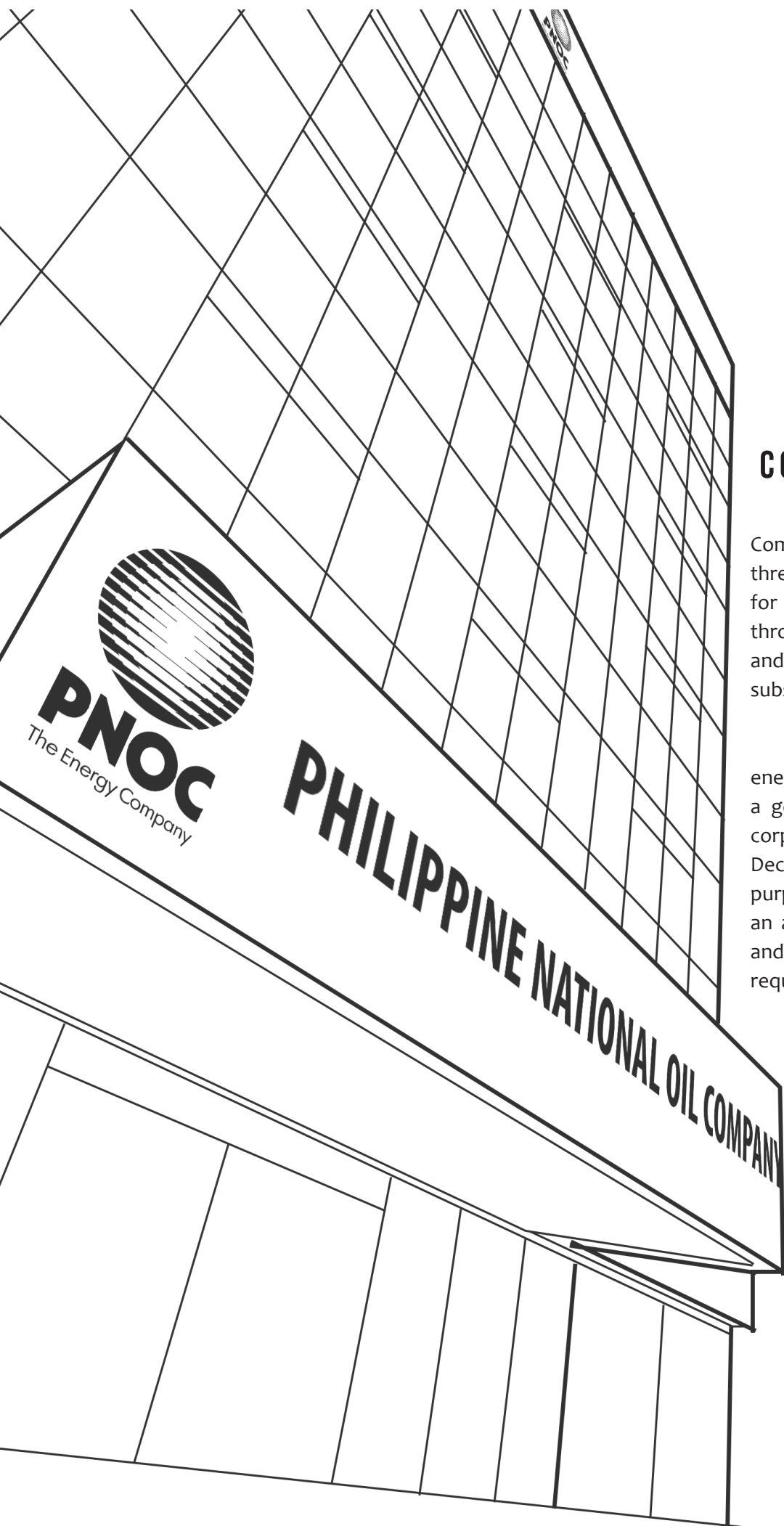
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2016
PHILIPPINE NATIONAL OIL COMPANY

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COMPANY PROFILE

The Philippine National Oil Company (PNOC) celebrates forty-three years of continuously providing for the energy needs of the country through its exploration, research, and development support to PNOC subsidiaries.

It was the onset of the 1973 energy crisis which gave birth to PNOC, a government-owned and controlled corporation, through Presidential Decree (PD) No. 334, with the primary purpose of providing and maintaining an adequate and stable supply of oil and petroleum products for domestic requirements.



HOW OUR CORE BUSINESS STARTED

The passing of the years has shown PNOC's areas of responsibilities evolving to meet the country's complex and growing needs. This is evidenced by the numerous subsidiaries created over time to address specific areas for development. In 1974, after purchasing Esso Phils., Inc., (now Petron Corporation), the largest oil firm in the country, three tanker corporations were created. A stevedoring corporation, the pre-cursor to the PNOC Shipping and Transport Corporation (PSTC), was acquired soon after to facilitate the movement of oil products throughout the country.

After the discovery of oil in Palawan in 1976 and seeing the potential of energy sources other than oil, PD 927 was enacted to promote the exploration and development of oil and other indigenous energy sources, effectively expanding PNOC's scope of operations. The Coal Development Act of 1976, set to establish a coal development program, later led to the creation of the PNOC Coal Corporation (PCC).

The year also saw the creation of two of PNOC's more lucrative subsidiaries – the PNOC Energy Development Corporation (PNOC EDC) and the PNOC Exploration Corporation (PNOC EC). PNOC EDC put the company on the map by making the Philippines the second largest producer of geothermal energy in the world. This geothermal energy contributed considerably to reducing the country's dependence on imported oil to about 50 percent. The \$5.0 billion Malampaya Deepwater Gas-to-Power Project heralds PNOC EC's participation in the largest and most important investment of its kind in the history of the Philippines.

PNOC's business ventures dealt with petrochemicals and real estate development. The PNOC Petrochemical Development Corporation's (PPDC) Petrochem Park was declared a flagship project under the Ramos Administration. The PNOC Development and Management Corporation (PDMC), on the other hand, was able to balance and maximize the use of PNOC land, both by earning from it through rentals or sale. PPDC was later reorganized and renamed PNOC Alternative Fuels Corporation (PAFC), in response to the call to discover and develop alternative sources of energy.

CHANGES

Having served the purpose for which it was established - that of serving the transport requirements of Petron for 30 years, the Boards of PSTC and PNOC approved in March 2013 the shortening of term of PSTC. This was subsequently ratified by the Governance Commission for Government Owned and Controlled Corporations (GCG).

Then in September 2014 during the PNOC's 2015 Performance Agreement Negotiation, GCG, citing rational and economic principles, directed PNOC to transform itself from a holding company to also an operating company. In line with this move, the GCG recommended the abolition of PAFC and PDMC, which was duly approved by the Office of the President that same month. The transition and

turnover plans for PAFC and PDMC were submitted to the GCG in February 2015 and their going concerns were continued and transitioned into PNOC in accordance with the plans.

To help fulfill its new role as an operating company, PNOC engaged the services of the Development Academy of the Philippines in September 2015 to assist in the organizational review and preparation of a PNOC restructuring plan. A proposed Table of Organization and functional statements were approved by the PNOC Board and submitted to the GCG on December 20, 2016.

WHERE WE ARE NOW

2016 was a transition year for PNOC. After the historic Philippine elections in May and the victory and rise of a popular Davao Mayor to the Presidency, PNOC again had to face new changes.

PNOC had three (3) Presidents during the year. The Company was under the helm of Mr. Antonio M. Cailao from September 2007 to February 29, 2016; Mr. John J. Arenas from March 11, 2016 to November 6, 2016; then Retired Admiral Reuben S. Lista from November 7, 2016 up to the present. Despite these changes in leadership, the Company continued to focus on its transformation from simply a holding to also an operating one.

Under its new setup in 2016, PNOC initially focused its efforts and resources on the following:

- Batangas-to-Manila Natural Gas Pipeline Project
- Sale of Banked Gas
- Assumption of PAFC's and PDMC's programs, activities and projects
- PNOC Restructuring Plan
- PNOC ISO Certification
- PNOC IMS Certification
- Winding down of PSTC operations

PNOC, as in the past years, derives its income mainly from its share of the gains from the Malampaya Gas to Power Project, earnings from short and long term investments in banks, and lease rentals from various property holdings.

Likewise, from a high of five, PNOC now only has two subsidiaries remaining, the PNOC-Exploration Corporation (PNOC-EC) and the PNOC-Renewables Corporation (PNOC-RC). PNOC will continue to act as a holding company in relation to PNOC-EC and PNOC-RC, but will also take over the programs and functions of the now moribund subsidiaries, PAFC and PDMC. With the assumption of PAFC's and PDMC's operations, the expanded mandate and the critical role of providing for energy that will play in the country's long-term plans for sustainable development, will require PNOC to reinvent itself into a far more competitive and dynamic government corporation than it has ever been.

WHERE WE ARE GOING

With the new administration under President Rodrigo R. Duterte, PNOC's business will have to expand to address the immediate need to ensure energy security by providing vital energy infrastructure and strategic reserves for the country.

In line with this, the five-year directives and priorities of PNOC include among others:

- a. the establishment of the PNOC Batangas LNG Hub which includes storage units, regasification/liquefaction plants, a modular gas power plant and distribution component;
- b. development of PNOC Batangas Properties to an Energy Hub that will include the take-

over of PNOC Exploration Corporation's Energy Supply Base (ESB) operations and its coal and oil trading business; and

- c. potential business ventures for several of PNOC's prime properties including those that were turned over by its dissolved subsidiaries, PAFC and PDMC, such as the PAFC Industrial Park in Limay, Bataan and properties in Rosario, Cavite, respectively, to maximize potentials for development and maximize its returns as well.

We expect that these programs will continue as the main businesses of PNOC in the years to come.

PROGRAMS & PROJECTS

Batangas to Manila (Batman 1) Natural Gas Pipeline Project

The BatMan 1 Natural Gas Pipeline Project, involving construction of approximately 121 kilometers of transmission gas pipeline from Batangas to Metro Manila, is the first among the planned series of network pipelines to be built in Luzon, which forms part of the natural gas master plan to develop the natural gas economy of the country.

The project is being developed for the purpose of reducing the country's dependency on traditional sources of energy such as liquid fossil fuel and increasing utilization of cleaner and cheaper energy sources.

In 2016, PNOC continued with the activities related to the development of the BATMAN Project. Among these is the Right-of-Way acquisition.

The main activity for 2016 involved coordination with the Toll Regulatory Board (TRB) and the Local Government Units (LGUs) which will be affected by the Project. TRB in its Letter of Instruction addressed to Southern Tagalog Arterial Road (STAR) & Southern Luzon Expressway (SLEX) operators, contained among others, provision of assistance to PNOC in its conduct of due diligence on the various infrastructures within the tollways.

During the year, PNOC was also able to secure "As Built" plans for the Project. PNOC presented the Batman 1 project to various LGUs, DPWH Districts 2 & 4 Engineering Offices of Lipa & Batangas Cities. It was able to secure the "As Built" plan of Manila-Batangas Road, Tambo Section, Lipa City, Batangas and the inventory inspection data of infrastructures particularly bridges along the national highways to be traversed by the pipeline, all under the administration of DPWH District 2, Batangas City, Batangas last April 2016. It also secured as-built plans for the Alabang-Calamba and the Calamba-Sto. Tomas sections of SLEX.

PNOC also presented the project to LGUs in Laguna, Cavite, Metro Manila and the Provincial Development Council of Laguna to secure their endorsements. An endorsement was secured from the municipalities of Ibaan and Malvar in Batangas and Carmona, Cavite.

Sale of Banked Gas

In September 2009, PNOC bought its banked gas asset from DOE for P1.4 billion equivalent to 108.6 petajoules. This natural gas was already paid for but not utilized, under the take-or-pay scheme of the Ilijan Gas Sales and Purchase Agreement (GSPA). The Company entered into a Joint Tender Agreement with the SC 38 Consortium to jointly sell PNOC's banked gas and SC 38's new gas through competitive



public bidding. The joint tender was conducted in 2015 and out of three pre-qualified bidders, Pilipinas Shell Petroleum Corporation was awarded the Gas Sales and Purchase Agreement (GSPA) with contract quantity of 14 petajoules (out of the combined 227.995 petajoules). Of the 14 petajoules PNOC share is 6.32 petajoules.

PNOC designated its subsidiary, PNOC Exploration Corporation (PNOC EC), which has a 10% stake in Malampaya, to negotiate on its behalf, the sale of the remaining volume of about 97 petajoules. Both companies have agreed to jointly sell the remaining volume through negotiation with an interested buyer.

In 2016, a non-binding Key Term Sheet was finalized between representatives of PNOC and the SC 38 Consortium on the sale of at least 30% (29.1 petajoules) of the total remaining volume of 97 petajoules.

PNOC Restructuring Plan

Until recently, PNOC has been a holding company, spinning off the business it creates for implementation by its subsidiaries. However, on September 2014, the GCG, citing rational and economic principles, directed PNOC to transform from a mere holding to also an operating company.

A Memorandum of Agreement with the Development Academy of the Philippines (DAP) was signed in September 2015 to assist in the preparation of a restructuring plan for submission to the GCG by end of 2016.

In compliance with the directive, PNOC's Restructuring Plan was approved by the PNOC Board in November and submitted to the GCG in December. Though still in the process of reorganizing, PNOC is gradually transitioning to be an operating company.

PNOC Industrial Park Integrated Management System (IMS) Re-certification (ISO 9001:2015, ISO 14001:2015, OHSAS 18001:2007) and PNOC Quality Management System (QMS) CERTIFICATION (ISO 9001: 2015)

With the promulgation of Executive Order No. 605, Institutionalizing the structure, mechanisms, and standards to implement the Government Quality Management Program (GQMP), the need for government agencies to improve quality in their operations and service delivery is fundamental.

PNOC hired a consultant in June 2016 to assist the company in establishing the PNOC Quality Management System that is certifiable to ISO 9001:2015 version. The consultant also assisted in the review, assessment and preparation of the QMS documentation compliant to ISO 9001:2015

In October 2016, the IMS Certification by a 3rd Party Certifying Body for the PNOC Industrial Park was completed. PNOC, on the other hand completed its QMS Internal Audit in November 2016.



Assumption of PAFC's and PDMC's Programs and Projects

As a result of the abolition of PAFC and PDMC in September 2014, their transition and turnover plans were submitted to the GCG in 2015.

By the second half of 2016, their remaining activities/operations were fully transitioned and turned over to PNOC and integrated into its operations. Moreover, PNOC continued the dissolution process for both companies.

PNOC - ALTERNATIVE FUELS CORPORATION

Among the activities/projects of PAFC turned over to PNOC in 2016 are the following:

1. Park Management and Operations

PNOC, through its Park Administrator, continued to manage park operations which is mainly providing basic services such as raw and fire water, power supply, and jetty services to the locators within the Park.

The Health, Safety, Security and Environmental (HSSE) Programs were also implemented throughout the Park. The HSSE Program facilitates the efficient operation in the Park and its compliance with various requirements of the government.

2. Study on Sweet Sorghum

The project was transferred to PNOC for possible investment consideration. Then PAFC Management initiated the conduct of a feasibility study entitled "Establishment of a Commercial Sweet Sorghum Plantation and a Sweet Sorghum Syrup Processing Plant in the Philippines" in partnership with NEDA as

the funding agency.

The University of the Philippines in Los Baños (UPLB) was tapped to do the project feasibility study which was submitted to PNOC in February 2016. The PNOC Investment Appraisal Committee (IAC) - Technical Secretariat (IAC-TS) completed the evaluation of the study in July and the results of the evaluation were endorsed to PNOC Management. The project was considered to be one of the strategic initiatives of PNOC (or SIs referring to the PAN) in its Corporate Strategic Plans and Programs.

3. Agreements with New Locators

A Lease Agreement and MOA with Energy Oil and Gas Holdings, Inc. (EOGHI) for the Energy City Project for a duration of 25 years was submitted to the PNOC Board for approval. It is currently being reviewed by the Joint Risk Management and Governance Committees of the PNOC Board.

A MOA was also signed between PAFC and SMC Consolidated Power Corporation to formalize the latter's intention to enter into the Lease Contract for an area of 149,329 square meters in the Industrial Park. SMC Consolidated intends to construct billeting, storage and other auxiliary facilities in Lamao, Limay and needs an additional area for this project. The Lease Agreement between PAFC and SMC Consolidated Power Corporation is currently being re-evaluated by the PNOC Board for their approval.

4. Updated Industrial Park Master Plan

PNOC/PAFC is currently complying with the requirements of the DENR Review Committee before DENR's final approval of the updated Industrial Park Master Plan.

One of the requirements is the use of a software, Phast Safeti. Coordination with DENR for the approval of the software to be used for the risk assessment program for implementation in 2016. In 2015, Management decided to rent, instead of buy, a new software, as the latter was too costly. A purchase requisition for Phast Safeti, was made in January 2016. PNOC received DENR's confirmation on the use of the software prior to its purchase. However, with the new leadership, the strategic plan for the entire Industrial Park is under review.

5. Persistent Organic Pollutants (POPs) Project

Since the signing of the Memorandum of Agreement (MOA) on the turnover of the POPs Project from PAFC to DENR in 2014, regular coordination meetings were conducted to formalize the official turnover of the POPs facility together with the chemicals, tools and equipment. Inventory review was done and the inventory list was finalized in 2015.

PAFC continued to provide security and utility services as a minimal way of securing the facility while commencing the said transfer. However, transfer is yet to be realized, pending talks with appropriate officials of the DENR.

PNOC - DEVELOPMENT AND MANAGEMENT CORPORATION

PNOC continued to dispose of the remaining assets of PDMC and assumed collections of sale proceeds and receivables. However, disposal of these assets was put on hold pending results of the study made by the Technical Working Group for a re-appraisal of the mentioned properties to maximize income from these properties.

1. Costa Verde Inventories

One (1) lot was sold with a Total Contract Price of P2.3 million and collected

P15.28 million in installment receivables. As of end December, there are a total of twenty-two (22) lots available for sale.

2. El Pueblo Condormitel Units

Three (3) units were sold with a Total Contract Price of P4.0 million. Collections registered at P6.87 million comprising of cash sales and down payment and amortization. As of end December, there are a total of seven (7) units available for sale.

3. Socialized Housing

PDMC sales and collection for Socialized Housing were turned over to Rosario, Cavite Local Government Unit in 2010. During the year, an amount of P2.0 million was received as remittance from the LGU.

4. Lease of Capital Assets

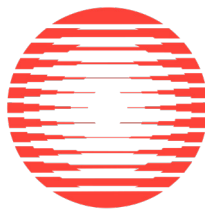
For the year, collections reached P9.3 million from the long term lease of its 4.9 hectare property inside the Cavite Economic Zone (CEZ) and from a commercial lot in Rosario, Cavite. Projected revenues were achieved due to updated rental payments by PEZA.

PNOC - SHIPPING AND TRANSPORT CORPORATION Winding Down Operations

PSTC filed answers to thirty-six (36) orders from the Commission on Audit (COA) relative to petitions for money claims filed by PSTC's creditors. However, COA dismissed the money claims filed in December 2016. COA stated that they could not give due course to these claims as this is under the powers of the Disposal Committee of PSTC.

The above claims will have to be reviewed again by PSTC and presented to the PNOC Board for approval in 2017.

2016 was an exciting and challenging year for the Company. As PNOC transitions into an operating company, the year primed PNOC for the vital role it will play in the new administration's thrust of energy efficiency and sufficiency.



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