

2004 Annual Report

Review of Operations

During the second half of the year 2004, oil exploration and development continued to gain momentum as oil companies worldwide rushed to build up their respective crude inventory in anticipation of further increases in oil price beyond the \$50 per barrel level.

As an offshoot of these developments in the international market, the Philippines witnessed a positive turn in the local exploration scene. Foreign players reaffirmed their serious interest in the development of some discovery areas, particularly in offshore Palawan, which were earlier deemed marginally viable due to depressed crude prices.

In the Gabon contract area, development and production activities were likewise stepped up to benefit from the very favorable prices of crude oil. For the second half of the year, the Etame crude fetched an average price of \$41.95 per barrel.

GABON, WEST AFRICA

Oil Production (Etame Field)

A fourth production well, ET-5H was added to the field and put on stream in August 2004. As a result, total production for the year increased to 6.3 million barrels with a total of 5.9 million barrels lifted as of end of December 2004. From September 2002 up to the end of 2004, the total production of the Etame Field, with current output of 19,000 BOPD, is 13,226,615 barrels.

Plans have likewise been set into motion to drill ET-6H, the fifth production well which will complete the development of the Etame Field.

It is anticipated that with gas lift facilities being set up for ET-5H and ET-6H, ultimate recovery will increase by 20 million, bringing the total developed and producible reserves of Etame to 58 million barrels.

Avouma-South Tchibala Field Development

The discovery well Avouma No. 1 which flowed 6,600 BOPD on test, confirmed the presence of commercial volumes of oil in an adjoining structure south of the South Tchibala discovery (discovered in 1981). With the addition of 4.9 million barrels from Avouma, the total proved reserves of the newly delineated field (South Tchibala-Avouma) is placed at a minimum of 17 million barrels which justifies its development.

The development plan calls for an unmanned platform situated between South Tchibala and Avouma, from which two horizontal production wells will be drilled. A 17 km pipeline will connect the Avouma platform to the FPSO of Etame. First oil from this field is expected in May 2006.

The new field is expected to add 15,000 BOPD to the current Etame output of 19,000 BOPD, and will bring the total proved producible reserves of our Gabon venture to 72 million barrels.

Ebouri and North Tchibala Pre-development

Site and seafloor survey of the Ebouri discovery area was conducted in preparation for its eventual development. Discovered in December 2003, Ebouri has proved reserves of at least 11 million barrels. Engineering studies have indicated that the field which is about 9 kilometers from the Etame production facilities can deliver at least 5,000 BOPD.

The North Tchibala discovery on the other hand, lies in the northern portion of the Tchibala-Avouma production block.

It has proved reserves of 18.5 million barrels mainly from the Dentale sandstones which lie below the productive Gamba sandstone reservoir in Etame.

Preliminary engineering studies are being conducted to determine its productive capacity with the end view of utilizing the Etame-Avouma pipeline to convey future production to the existing Etame FPSO.

Exploration and Prospect Generation

The exploration activities continue in the larger retention area of the Etame contract area, particularly those within the effective radius of the existing production facilities in the Etame and South Tchibala Fields.

In May 2005, an exploratory well, Eavosm No.1 was drilled to test another prospect just 4 kilometers south of Avouma discovery well. The objective Gamba reservoir which was encountered at a deeper level was found dry.

Several more prospects (Prospect M, J, A) are the subject of ongoing evaluation.

PHILIPPINE AREAS

In line with its formulated business plan, PetroEnergy has maintained its involvement only in Philippine areas with known hydrocarbon manifestations.

SERVICE CONTRACT 14-C

West Linapacan

Spurred by the high crude oil prices, more foreign companies have expressed interest in reactivating the West Linapacan oil field.

Offers range from simple re-opening of the existing wells (assuming all flow lines are functional) to full development, by drilling new production wells which can drain the reservoir with higher efficiency. While the original re-activation plan was forecast to produce some 2 to 3 million barrels of oil in 2 years, the full development scheme expects a considerably much larger volume of production over a longer period of time.

Under these different schemes, the consortium is expected to farm out 75% participating interest for a full carry throughout production. Options are currently being weighed by consortium members as to the most advantageous production approach and farm out terms.

Galoc Area

The proposed program of development of the Galoc area has progressed significantly after the group of Team Oil and Cape Energy completed

most of the requisite farm-in terms. The Philippine consortium will soon assign the 75% interest to the farminees, in exchange for which, the consortium will be carried free of cost for the development and production of the Galoc oil field.

Earlier, the farm-in parties of Team Oil and Cape Energy have completed the subsurface and modeling work in preparation for the independent field reserves audit. Timeline shows that the farm-in group intends to fast track the project to have first oil by fourth quarter of 2006, or second quarter of 2007, at the latest.

The Galoc field has estimated recoverable reserves of 23 Million barrels based on the studies of UNOCAL.

SERVICE CONTRACT 41-C

Sulu Sea

After drilling two back to back wells in June up to July of 2004, and having declared both wells as dry holes, all the foreign partners in the consortium withdrew from the Service Contract before entering the 8th contract year. The Filipino Group decided to continue with the Service Contract. The Group submitted a work program to the Department of Energy which will entail a

serious study and review of seismic and well data to find some alternative exploration approach which can hopefully bring more positive results.

Having secured the Department of Energy approval to carry out the geologic and geophysical work program, the consortium elected Basic Petroleum as the new operator who will spearhead the exploration efforts in the coming contract year.

SERVICE CONTRACT 47

Offshore Mindoro

Service Contract 47 in offshore Mindoro was scheduled to be signed in 2004 with PETRONAS Carigali as operator. However, the Supreme Court's ruling certain provisions of the Mining Act of 1995 as unconstitutional resulted in PETRONAS' request to defer the signing. They were concerned that this ruling may also apply to the petroleum service contract. The opinion of the Department of Justice and an independent legal counsel was sought and requested from the Department of Energy for term extensions of the GSEC.

After the Supreme Court's ruling was reversed, the service contract was signed and awarded by the Department of Energy on January 10, 2005.

An exploration well has been committed for drilling in the first quarter of 2006 which will test at least one of the highly promising prospects inside the block. PetroEnergy has a small residual interest in this area which is warehoused with PNOC-EC.

SERVICE CONTRACT 6A

Octon-Malajon

This Service Contract was acquired in 1976. In the process of its long history of exploration, several prospects involving various exploration plays were mapped, and subsequently, 6 wells were drilled, testing the different prospects.

While all the wells encountered oil shows and even tested hydrocarbons (condensate and gas in Octon No.1 and oil in Octon No. 2), the recoverable reserves were deemed sub-economic. That oil has been generated in this basin has been proven repeatedly, but commercial accumulation has not been found.

Studies are now focused in the area of Malajon, where reservoir rocks are believed to have been better developed. In 1977 the well Malajon No. 1 was drilled by AMOCO to test an uplifted fault block. Further in 1988, two wells (Saddle Rock No. 1 and Esperanza

No. 1) were drilled by the new Operator, Philodrill. Oil shows were recorded in all these wells, but were deemed noncommercial.

If plans don't miscarry, a well may be drilled in this prospect in 2006.

EAST VISAYAN SEA SERVICE CONTRACT APPLICATION

Based on the encouraging results of the stratigraphic wells drilled in NW Leyte in 2003 and the successful reprocessing of vintage seismic data, the consortium, composed of PetroEnergy, Alcorn Gold and Trans Asia Resources applied for a Service Contract covering 444,000 hectares of onshore NW Leyte and the Visayan Sea.

The Department of Energy approved the proposed work program composed of further acquisition of 200 line kilometers of seismic data to refine the delineation of the structures earlier mapped. An optional well may be drilled after the eighteen months of geologic and geophysical studies. The consortium was given 18 months from award of Service Contract to commit to drill a well or drop the acreage.

In parallel event, the consortium entered into a Memorandum of Agreement with AustralAsian, an exploration company based in Perth, Australia, to farm out 80% participating interest in the Contract area for a carried position in the seismic acquisition, and the drilling of one of the offshore prospects adjacent to the eastern shoreline of Cebu Island. Under this agreement, if AustralAsian fails to commit to drill a well after the completion of the seismic survey, all interests will revert to the consortium.

The assignment of interest to AustralAsian will take effect as soon as the Service Contract is signed by the Department of Energy.