Woodward, Inc.
Form DEF 14A
December 18, 2018
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SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities

Exchange Act of 1934

Filed by the Registrant

Filed by a Party other than the Registrant

Check the appropriate box:

Preliminary Proxy Statement

Confidential, for Use of the Commission Only (as permitted by Rule 14a-6(e)(2))

Definitive Proxy Statement

Definitive Additional Materials

Soliciting Material under §240.14a-12

WOODWARD, INC.

(Name of Registrant as Specified In Its Charter)

(Name of Person(s) Filing Proxy Statement, if other than the Registrant)

Payment of Filing Fee (Check the appropriate box):

No fee required.

Fee computed on table below per Exchange Act Rules 14a-6(i)(4) and 0-11

1) Title of each class of securities to which transaction applies:

2) Aggregate number of securities to which transaction applies:

3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (Set forth the amount on which the filing fee is calculated and state how it was determined):

4) Proposed maximum aggregate value of transaction:

5) Total fee paid:

Fee paid previously with preliminary materials.

Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a)(2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

1) Amount Previously Paid:

2) Form, Schedule or Registration Statement No.:

3) Filing Party:

4) Date Filed:

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Woodward, Inc.

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Fort Collins, Colorado 80524

Tel: 970-482-5811

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WOODWARD, INC.

NOTICE OF 2018 ANNUAL MEETING OF STOCKHOLDERS

AND PROXY STATEMENT

December 18, 2018

Dear Stockholder:

You are cordially invited to join our Board of Directors and senior leadership at Woodward, Inc. s Annual Meeting of stockholders at 8:00 a.m., Mountain Standard Time, on Wednesday, January 30, 2019, at The Elizabeth Hotel located at 111 Chestnut Street, Fort Collins, Colorado. Please follow posted signs directing you to the registration table. We also invite you to join our directors and members of our management team for a continental breakfast at 7:30 a.m. The formal meeting will begin promptly at 8:00 a.m.

Garage parking is available on site for a fee, and nearby two hour street parking is available at no charge. A map is located on the back of this proxy statement.

Your vote is very important to us and to the continued success of our Company. Please complete and return your proxy card by mail, or vote via telephone or the Internet, as soon as possible regardless of whether you plan to attend in person. Thank you in advance for your continuing commitment to Woodward.

Sincerely yours,

WOODWARD, INC.

Thomas A. Gendron

Chairman, Board of Directors

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NOTICE OF ANNUAL MEETING OF STOCKHOLDERS

Important Notice Regarding the Availability of Proxy Materials for our Annual Meeting to be Held on January 30, 2019:

This Proxy Statement and our Annual Report on Form 10-K for the fiscal year ended September 30, 2018, including consolidated financial statements, are available to you at www.proxydocs.com/wwd.

Date and Time:

Wednesday, January 30, 2019

8:00 a.m., Mountain Standard Time

Place:

The Elizabeth Hotel

111 Chestnut Street

Fort Collins, Colorado

The purpose of our Annual Meeting is to:

1. Elect as directors the four nominees identified in this proxy statement, each to serve for a term of three years;

2. Ratify the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending September 30, 2019;

3. Vote on an advisory resolution regarding the compensation of the Company s named executive officers;

4. Approve amendments to the Amended and Restated Woodward, Inc. 2017 Omnibus Incentive Plan, including an increase in the number of shares reserved for issuance by 1,400,000; and

5. Transact other business that properly comes before the meeting, or any postponement or adjournment thereof.

Stockholders who owned Woodward, Inc. common stock at the close of business on the record date, December 3, 2018, are entitled to vote at the meeting, or any postponement or adjournment thereof.

By Order of the Board of Directors,

WOODWARD, INC.

A. Christopher Fawzy

Corporate Secretary

December 18, 2018

YOUR VOTE IS IMPORTANT

Even if you plan to attend the meeting in person, please date, sign, and return your proxy card in the enclosed envelope, or vote via telephone or the Internet, prior to the meeting and as soon as possible. Your prompt response is helpful and your cooperation will be appreciated.

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ANNUAL REPORT ON FORM 10-K

You may obtain a free copy of our Annual Report on Form 10-K for the year ended September 30, 2018, filed with the Securities and Exchange Commission (SEC) and available at its website at www.sec.gov. Please contact the Corporate Secretary, Woodward, Inc., 1081 Woodward Way, Fort Collins, Colorado 80524 or email investor.relations@woodward.com. This report is also available at www.proxydocs.com/wwd.

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ABOUT THE ANNUAL MEETING AND VOTING

Woodward, Inc. (Woodward or the Company), on behalf of its Board of Directors (the Board), is soliciting your proxy to vote at our Annual Meeting of Stockholders to be held on January 30, 2019 (or at any postponement or adjournment of the meeting) (the Annual Meeting). This proxy statement summarizes the information you need to know to vote at the meeting.

We began mailing this proxy statement and the enclosed proxy card on or about December 18, 2018, to all stockholders entitled to vote at the Annual Meeting. The Woodward, Inc. Annual Report, which includes our most recent audited financial statements, is also being distributed with this proxy statement.

Who Can Vote at the Meeting?

Stockholders who owned Woodward common stock at the close of business on the record date, December 3, 2018, are entitled to vote at the meeting. As of the record date, there were 61,834,973 shares of Woodward common stock outstanding.

How many votes do I get per share?

Each share of Woodward common stock that you own entitles you to one vote on each matter to be presented at the Annual Meeting, except for the election of directors, for which you may cumulate your votes. Since four directors are standing for election, you will be entitled to four director votes for each share of stock you own. Of this total, you may choose how many votes you wish to cast for each director. The Board is not soliciting discretionary authority to cumulate votes with respect to the election of directors.

How do I vote?

Woodward offers stockholders the opportunity to vote by mail, by telephone, or via the Internet. Instructions to use these methods are set forth on the enclosed proxy card. We urge you to vote promptly, even if you plan to attend the Annual Meeting in person.

If you vote by telephone or via the Internet, please have your proxy or voting instruction card available. A telephone or Internet vote authorizes the named proxies in the same manner as if you marked, signed, and returned the card by mail. Voting by telephone and via the Internet are valid proxy voting methods under the laws of Delaware (our state of incorporation) and our Amended and Restated Bylaws (our Bylaws).

If you properly fill in your proxy card and send it to us in time to vote, your shares will be voted as you have directed. If you sign the proxy card but do not make specific choices, your shares will be voted in accordance with the Board s recommendation as follows:

FOR the election of each of the Board s nominees to the Board;

FOR the ratification of the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm;

FOR the advisory resolution regarding the compensation of the Company s named executive officers; and

FOR the approval of the amendments to the Amended and Restated Woodward, Inc. 2017 Omnibus Incentive Plan, including an increase in the number of shares reserved for issuance by 1,400,000.

If any other matter is presented at the meeting, your shares will be voted in accordance with the proxyholder s best judgment. At the time this proxy statement was printed, we were not aware of any additional matters to be acted on at the meeting.

How do I change my vote or revoke my proxy?

You may revoke your proxy by:

Entering a new vote by telephone, over the Internet, or by signing and returning another signed proxy card at a later date,

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ABOUT THE ANNUAL MEETING AND VOTING (continued)

Notifying our Corporate Secretary in writing before the meeting that you have revoked your proxy, or

Voting in person at the meeting.

If you want to give your written proxy to someone other than the individuals named on the proxy card:

Cross out the individuals named and insert the name of the individual you are authorizing to vote, or

Provide a written authorization to the individual you are authorizing to vote along with your proxy card.

If you hold your shares through a broker, bank or other nominee, please follow the instructions on the Voting Instruction Form you receive from your broker.

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SUMMARY OF PROPOSALS SUBMITTED FOR VOTE

The following are only summaries of the proposals to be presented at the Annual Meeting. You should review the full discussion of each proposal in this proxy statement before casting your vote.

Proposal 1: Election of Directors

Director Nominees: At the Annual Meeting, you will be asked to elect to the Board the four nominees for director identified in this proxy statement. Each director will be elected to serve a three-year term and will hold office until the 2021 Annual Meeting held in or about January 2022 and until a successor is elected and qualified.

Vote Required: Because this is an uncontested election, directors are elected by a majority vote. A nominee for director in an uncontested election will be elected if the votes cast for that nominee s election exceed the votes cast against that nominee s election. Abstentions and broker non-votes will not be considered in the calculation. We have adopted a director resignation policy. Accordingly, each director has submitted an irrevocable resignation contingent upon not receiving a majority of votes in an uncontested election and acceptance of the resignation by the Board.

Proposal 2: Ratification of the Appointment of Independent Registered Public Accounting Firm

Independent Registered Public Accounting Firm: At the Annual Meeting, you will be asked to ratify the Audit Committee s appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending September 30, 2019.

Vote Required: The affirmative vote of the holders of a majority of shares of Woodward common stock present in person or by proxy and entitled to vote on the matter at the Annual Meeting will be required to ratify the Audit Committee s appointment of the independent registered public accounting firm. Abstentions will count as a vote against the proposal. Broker non-votes will have no effect on the outcome of the vote.

Proposal 3: Approval of Advisory Resolution Regarding the Compensation of the Named Executive Officers

Compensation of the Company s Named Executive Officers: At the Annual Meeting, you will be asked to approve an advisory resolution regarding the compensation of the Company s named executive officers.

Vote Required: The affirmative vote of the holders of a majority of shares of Woodward common stock present in person or by proxy and entitled to vote on the matter at the Annual Meeting will be required for the approval of the advisory resolution regarding the compensation of the Company s named executive officers. Abstentions will count as a vote against the proposal. Broker non-votes will have no effect on the outcome of the vote.

This proposal 3, commonly referred to as a say-on-pay proposal, is not binding on the Board or the Compensation Committee. However, the Board and the Compensation Committee will review and consider the voting results when evaluating our executive compensation program.

Proposal 4: Approval of Amendments to the Woodward Omnibus Incentive Plan

Amendments to the Woodward Omnibus Incentive Plan: At the 2016 Annual Meeting, stockholders of the Company approved the Woodward, Inc. 2017 Omnibus Incentive Plan, as further amended and restated at the 2017 Annual Meeting (the Woodward Omnibus Incentive Plan or the Omnibus Incentive Plan). At the 2018 Annual Meeting, you will be asked to approve additional amendments to the Woodward Omnibus Incentive Plan, including an increase in the number of shares reserved for issuance thereunder by 1,400,000.

Vote Required: The affirmative vote of a majority of the votes cast on Proposal 4 at the Annual Meeting will be required for the approval of the amendments to the Omnibus Incentive Plan. With respect to Proposal 4,

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SUMMARY OF PROPOSALS SUBMITTED FOR VOTE (continued)

abstentions will have the effect of a vote against the proposal. Broker non-votes will have no effect on the outcome of the vote.

The Board unanimously recommends that the stockholders vote FOR the election of each of the director nominees and FOR each of proposals 2 through 4 listed above.

Quorum

A quorum of stockholders is necessary to hold a valid meeting. The presence, in person or by proxy, at the Annual Meeting of holders of shares representing a majority of the votes of the common stock entitled to vote constitutes a quorum. Abstentions and broker non-votes are counted as present for establishing a quorum. A broker non-vote occurs when a stockholder does not provide voting instructions to his or her broker or nominee and the broker or nominee does not have discretionary authority to vote on the matter, as further described below under Voting of Shares Held in Street Name by Your Broker.

Abstentions

Abstentions are counted as present for establishing a quorum. For all proposals in this proxy statement, except for the election of directors, abstentions have the same effect as votes against the matter.

Voting of Shares Held in Street Name by Your Broker

If your shares are held in a stock brokerage account or by a bank or other nominee, you are considered the beneficial owner of shares held in street name and these proxy materials are being forwarded to you by your broker or nominee who is considered, with respect to those shares, the stockholder of record. As the beneficial owner, you have the right to direct your broker how to vote your shares. You are also invited to attend the Annual Meeting and vote your shares in person. In order to vote your shares in person, you must provide us with a legal proxy from your broker.

Brokerage firms have authority to vote customers shares for which they have not received voting instructions on certain routine matters, such as ratification of the auditors. If you do not provide voting instructions, your brokerage firm may either vote your shares on routine matters or leave your shares unvoted. On the other hand, absent instructions from customers, a brokerage firm cannot vote customers shares on non-routine matters, such as the election of directors, the advisory resolution regarding the compensation of our named executive officers, and the approval of the amendments to the Omnibus Incentive Plan. The shares for which instructions are not given and therefore, remain unvoted, are referred to as broker non-votes. For the purposes of this Annual Meeting, the only routine matter is the Ratification of the Appointment of our Independent Registered Public Accounting Firm. Consequently, if you do not give your brokerage firm specific instructions, your shares will not be voted on the other, non-routine, matters and will not be counted in determining the number of shares necessary for approval, although they will count for purposes of determining whether a quorum exists. We encourage you to provide instructions to your brokerage firm. This ensures your shares will be voted at the meeting.

In order for your shares to be voted on all matters presented at the Annual Meeting, including the election of directors, we urge all stockholders whose shares are held in street name by a brokerage firm to provide voting instructions to the brokerage firm.

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BOARD OF DIRECTORS

Woodward s certificate of incorporation provides for the Board to be divided into three classes, designated Class I, Class II and Class III, with directors in each class serving a three-year term. Woodward s certificate of incorporation further provides that the Board must consist of no less than six directors. The exact number of directors serving on the Board, and the exact number of directors in each class, is determined from time to time by resolution of the Board. If the number of directors changes, any increase or decrease must be apportioned among the classes so as to maintain the number of directors in each class as nearly equal as possible. The Company s Bylaws and Director Guidelines provide that directors are elected by a majority of the votes cast and we have a corresponding resignation policy for uncontested director elections. Contested elections are determined by a plurality vote.

The Board s three classes are currently comprised of three Class I directors, four Class II directors, and three Class III directors. Each of the four directors identified in this proxy statement as standing for election at the 2018 Annual Meeting of Stockholders has been nominated by the Board at the recommendation of the Nominating and Governance Committee to hold office for a three-year term expiring in January 2022, or when a successor is elected and qualified. Ms. Drake is standing for election by stockholders for the first time. Messrs. Cohn, Rulseh and Sengstack are incumbents. Directors identified in this proxy statement who are not standing for election at this meeting will continue in office for the remainder of their respective terms.

If a nominee is unavailable for election, proxy holders will vote for another nominee proposed by the Nominating and Governance Committee.

We identify below certain biographical information of each of our directors and the director nominees for election, including his or her principal occupation, public company directorships currently held or held during the past five years and other business affiliations. We also describe the specific experience, qualifications, attributes and skills of each director and director nominee that led the Board to conclude that he or she should serve as a member of the Board.

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BOARD OF DIRECTORS (continued)

PROPOSAL 1 ELECTION OF DIRECTORS

Directors Standing for Election at This Meeting for Terms Expiring in 2022:

John D. Cohn	Mr. John D. Cohn has served as Senior Vice President, Asia Business Planning and Execution, of Rockwell Automation, Inc. (Rockwell Automation), a global provider of innovative industrial automation and information products, services and solutions, since September 2011. In this capacity, Mr. Cohn develops and implements regional and country level business strategies for approximately $1 billion of Rockwell Automation sales. Additionally, Mr. Cohn leads business development activities, industry business plans, and other market expansion opportunities to drive revenue and profitable growth for Rockwell Automation on a global basis. Prior to accepting this position, Mr. Cohn served as Rockwell Automation s Senior Vice President, European Business Planning and Execution, from March 2009 to August 2011, and as Senior Vice President, Strategic Development and Communications, from 1999 to 2009. Mr. Cohn brings to the Board expertise in global market and business development, execution of focused initiatives, and experience with leading organizations through change management, mergers and acquisitions. He also has extensive knowledge and direct experience in both the industrial and aerospace markets.
Age: 64	Other public company directorships: None held during the past five years.
Director since: 2002	
Lead Director	

Eileen P. Drake

Ms. Eileen P. Drake has served as Chief Executive Officer and President of Aerojet Rocketdyne Holdings, Inc., a manufacturer of aerospace and defense products, since June 2015. She joined Aerojet Rocketdyne in March 2015 as Chief Operating Officer. Ms. Drake was previously with United Technologies Corporation (UTC) from November 2003 through February 2015, where she served as President of Pratt & Whitney AeroPower s auxiliary power unit and small turbojet propulsion business from January 2012 through January 2015. She also held other various senior level roles during her tenure at UTC. Prior to joining UTC, Ms. Drake held various senior level roles with Ford Motor Company between 1996 and 2003. Ms. Drake served on active duty for seven years as a U.S. Army aviator and airfield commander of Davison Army Airfield in Fort Belvoir, Virginia.

Ms. Drake is an accomplished, dynamic leader with extensive experience in profit and loss management, operations, quality and supply chain. She brings to the Board extensive experience in the Aerospace industry and a results-oriented mentality.

Other public company directorships: Aerojet Rocketdyne Holdings, Inc. (since 2015).

Age: 52

Director since: 2017

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BOARD OF DIRECTORS (continued)

James R. Rulseh	Mr. James R. Rulseh has served as President of JRR & Associates, LLC, an independent manufacturing consulting company focused on operations improvement and operational leadership excellence, since May 2011. Prior to May 2011, Mr. Rulseh served as the Chief Operating Officer, Tulip Corporation, a private manufacturing company, since October 2009. Prior to joining Tulip Corporation, Mr. Rulseh served in the following capacities for Modine Manufacturing Company, an NYSE listed company that is a diversified global leader in thermal management technology and solutions: Special Assistant to the Chief Executive Officer, from January 2009 to October 2009; Regional Vice President Americas, and an officer of Modine Manufacturing Company, from October 2007 to January 2009; Regional Vice President Asia and an officer of Modine Manufacturing Company, from November 2006 to October 2007; Group Vice President and an officer of Modine Manufacturing Company, from April 2001 to November 2006; Managing Director of the Automotive Business Unit of Modine Europe, from 1998 to March 2001. Prior to 1998, Mr. Rulseh had held various other positions with Modine beginning in 1977.
Age: 63	Mr. Rulseh s experience as a Global Business Advisor, COO of Tulip Corporation and his extensive operational management experience at Modine Manufacturing Company provide him with significant insight and experience into the operations, challenges and complex issues facing major manufacturing corporations such as Woodward. Mr. Rulseh also brings to the Board extensive senior executive level experience in international manufacturing and business restructurings.
Director since: 2002	
	Other public company directorships: Accuride Corporation (2013-2016).
Gregg C. Sengstack	Mr. Gregg C. Sengstack was appointed Chief Executive Officer of Franklin Electric Co., Inc. (Franklin Electric), a manufacturer and distributor of water and fuel pumping systems, in May 2014, and Chairman in May 2015. He has been President of Franklin Electric since December 2011. Franklin Electric is a global leader in the production and marketing of systems and components for the movement of water and automotive fuels. Mr. Sengstack was President of Franklin Electric s International Water Systems and Fueling Group from 2005 to 2011, and was Chief Financial Officer for Franklin Electric from 1999 to 2005. Mr. Sengstack joined Franklin Electric in 1988 and has worked on numerous acquisitions in the U.S. and overseas during his career.

Mr. Sengstack s combination of P&L, finance, international and general management and top leadership experience, as well as his consensus-driven global leadership style and experience working with boards, allow him to provide the Board with strong insight into the Company s multi-national markets and operations.

Other public company directorships: Franklin Electric Co., Inc. (since 2014).

Age: 60

Director since: 2011

Your Board unanimously recommends a vote FOR each of the nominees presented in Proposal 1.

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BOARD OF DIRECTORS (continued)

Directors Remaining in Office Until 2020:

Mary L. Petrovich	Ms. Mary L. Petrovich has been serving as a senior advisor to private equity with the Carlyle Group and American Security Partners since June 2011. Prior to this role, Ms. Petrovich served as General Manager of AxleTech International, a supplier of off-highway and specialty vehicle drive train systems and components, after its acquisition by General Dynamics in December 2008. Ms. Petrovich served as Chairman and Chief Executive Officer of AxleTech International from 2001 through the December 2008 sale of the company to General Dynamics. Prior to AxleTech, in 2000, Ms. Petrovich was President of the Drivers Controls Division of Dura Automotive, possessing management responsibility for 7,600 employees.
Age: 55	Ms. Petrovich has extensive experience with mergers, acquisitions and the integration of acquired businesses in the automotive, off-highway and transportation industries. This experience, together with her operational experience with Six Sigma lean manufacturing techniques and supply chain management, and her experience in evaluating new business opportunities, provides the Board with valuable knowledge in its oversight of Woodward s operational efficiency and recent acquisitions.
Director since: 2002	Other public company directorships: WABCO (since 2011); GT Advanced Technologies Inc. (2011-2014); Modine Manufacturing Company (2011-2014).
Paul Donovan	Mr. Paul Donovan retired in 2004 as special advisor to the Chairman of Wisconsin Energy Corporation. Mr. Donovan had previously served as the Executive Vice President and Chief Financial Officer of Wisconsin Energy Corporation from 1999 until 2003. Prior to joining Wisconsin Energy Corporation, Mr. Donovan was Executive Vice President and Chief Financial Officer of Sundstrand Corporation, a manufacturer of aerospace and industrial products, from June 1988 to August 1999. Prior to June 1988, he held a variety of financial positions, including at Allied Signal and Ford Motor Company.

Mr. Donovan s demonstrated leadership of large company corporate finance and tax departments provides the Board with expertise regarding the intricacies of tax, banking, finance, and mergers and acquisitions. He also possesses direct knowledge of the power generation, transportation and aerospace markets, all of which are key business segments for Woodward. As a former member of the Office of the Chairman at Wisconsin Energy and a former member of the Executive Office at Sundstrand Corporation, Mr. Donovan contributes to the Board not only his strong knowledge of the markets in which Woodward competes, but also strong leadership and insight into large organizations.

Age: 71

Other public company directorships: CLARCOR, Inc. (2003-2017).

Director since: 2000

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BOARD OF DIRECTORS (continued)

Jonathan W. Thayer	Mr. Jonathan W. Thayer was appointed Chief Transformation Officer of Exelon Corporation (Exelon), an energy provider and holding company for several energy businesses in May 2018, and has served as Senior Executive Vice President since 2014. Mr. Thayer served as Chief Financial Officer of Exelon from 2012 until May 2018. Prior to joining Exelon, Mr. Thayer held the position of Senior Vice President, Chief Financial Officer for Constellation Energy Group, Inc. (Constellation Energy) from October 2008 until Constellation Energy s acquisition by Exelon in 2012. Mr. Thayer was also appointed Treasurer of Constellation Energy in August 2008, and held prior positions of Vice President and Managing Director, Corporate Strategy and Development (2004-2008) and Director, Investor Relations (2003-2004). Prior to joining Constellation Energy, Mr. Thayer held financial positions at Deutsche Bank Securities, Inc. and SBC Warburg Dillon Read, Inc.
Age: 47	Mr. Thayer brings to the Board expertise in corporate finance and strategy, equity offerings, complex M&A transactions, including post acquisition integration, and risk management. He is experienced in leading across periods of growth, maturation, disruption, and crisis. Mr. Thayer has a strong sense of board governance, and an understanding of promoting shareholder value and investor relations.
Director since: 2016	Other public company directorships: None held during the past five years.

Directors Remaining in Office Until 2021:

Thomas A. Gendron	Mr. Thomas A. Gendron has been Chairman of the Board of the Company since January 2008, and has been President and Chief Executive Officer of the Company since July 2005. Mr. Gendron previously served as Chief Operating Officer and President of the Company from September 2002 until July 2005, and as Vice President and General Manager of Industrial Controls from June 2001 until September 2002. Prior to that, Mr. Gendron served as Vice President of Industrial Controls from April 2000 through May 2001, and as Director of Global Marketing and Industrial Controls Business Development from February 1999 through March 2000. Overall, Mr. Gendron has served with Woodward for over 25 years in both the aircraft and industrial businesses, providing leadership in sales, marketing, business development,

and product support management.

His experience with and knowledge of the Company s businesses and the industries in which they operate has enabled Mr. Gendron to lead the Company s growth since his appointment to President and Chief Operating Officer in September 2002. He has brought significant insight to the Board due to his comprehensive understanding of the Company and its operations at multiple levels, including the Company s strategic vision, products, suppliers, customers and markets.

Age: 57

Other public company directorships: Hexcel Corporation (since 2010).

Director since: 2005

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BOARD OF DIRECTORS (continued)

Daniel G. Korte	Mr. Daniel G. Korte joined PPG Industries, Inc. (PPG) in May 2018 as Global Vice President-elect of its Aerospace Products business. Mr. Korte s appointment of Global Vice President, Aerospace was effective as of August 1, 2018. Prior to joining PPG, Mr. Korte served as Chief Executive Officer of LMI Aerospace, Inc. (LMI), now part of the Sonaca Group, from February 2014 through October 2017. Prior to joining LMI, Mr. Korte was the President of the Rolls-Royce Defense Group in Washington, DC and London, UK from 2009 through 2012. From 1985 through 2009, Mr. Korte held various senior level roles at The Boeing Company in supply chain, program management and general management. Mr. Korte is a results-oriented leader, skilled in identifying and capitalizing on global market opportunities that drive revenue and profitable growth. His experience and strong contributions in the commercial and defense aerospace markets brings a valuable set of skills to the Board. Other public company directorships: LMI Aerospace, Inc. (2014-2017).
Age: 58	
Director since: 2017	
Ronald M. Sega	Dr. Ronald M. Sega has served as Director, Systems Engineering Programs at Colorado State University (CSU) and Special Assistant to the Chancellor for Strategic Initiatives since September 2013. Prior to this role, he was Vice President and Enterprise Executive for Energy and the Environment at CSU and The Ohio State University (OSU) from September 2010 through August 2013. CSU and OSU are two Land-Grant universities engaged in efficient, sustainable development of practical products using our natural resources through education, research and outreach. At CSU, he served as chair of the Sustainability, Energy, and Environment Advisory Committee. Dr. Sega also served as chair of the President s and Provost s Council on Sustainability at OSU. Dr. Sega held the position of Vice President for Energy, Environment, and Applied Research with the CSU Research Foundation from September 2007 through August 2010. Prior to joining CSU, Dr. Sega served as Under Secretary for the U.S. Air Force

from August 2005 to August 2007. As Under Secretary, Dr. Sega led a team that developed a comprehensive energy strategy emphasizing supply, demand, and culture with results in 2006 leading to the receipt of the overall Presidential Award for Leadership in Federal Energy Management for the U.S. Government. As Under Secretary, Dr. Sega also acted as the Department of Defense (DOD) Executive Agent for space, and the Air Force Service Acquisition Executive for space programs. From August 2001 until August 2005, Dr. Sega was Director of Defense Research and Engineering, Office of the Secretary of Defense, which is the Chief Technology Officer for the DOD. From July 1996 to August 2001, he served as Dean, College of Engineering and Applied Science, University of Colorado at Colorado Springs.

Age: 66

Dr. Sega is a former NASA astronaut and veteran of two shuttle missions. He retired from the U.S. Air Force in the rank of Major General. Dr. Sega is a Fellow of the American Institute of Aeronautics and Astronautics, as well as a Fellow of the Institute of Electrical and Electronics Engineers.

Director since: 2008

Dr. Sega brings to the Board extensive experience applying academic research to real-world situations, knowledge of U.S. government contracting practices, and expertise in aerospace and energy technology and markets.

Other public company directorships: Rentech, Inc. (2007-2018).

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GOVERNANCE

Governance Documents

Woodward s policies and practices reflect corporate governance initiatives that are compliant with the listing requirements of the NASDAQ Stock Market (NASDAQ), SEC rules and regulations, and the applicable corporate governance requirements of the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). We maintain a corporate governance page on our website at www.woodward.com that can be accessed by clicking on Investors and then on Corporate Governance. Included on this site are a message from our Chairman and Chief Executive Officer and the following documents adopted by our Board:

- The Woodward Constitution;
- Director Guidelines;
- Executive/Director Stock Ownership Guidelines;
- The Woodward Code of Business Conduct and Ethics for directors, officers, and employees (who we refer to as members);
- Woodward Code of Ethics for Senior Financial Officers and Other Finance Members;
- Policy relating to Insider Trades of Woodward Stock;
- Clawback Policy; and
- Related Person Transaction Policies and Procedures.

A link to EthicsPoint, our third-party help-line reporting system provider, is also provided. Charters for our Audit Committee, Compensation Committee, Executive Committee, and Nominating and Governance Committee can be found by clicking on Investors, then selecting Board of Directors, and then clicking on the Board Committees and Charters link.

Sustainability

Woodward s mission is to set the global standard in energy control solutions for the aerospace and industrial markets and promote sustainable solutions by optimizing energy use through improved efficiency and lower emissions. Woodward s commitment to sustainability extends to several aspects of our business, including:

- Products and Facilities Clean energy technologies and innovative product and facility designs contribute to the global reduction of harmful emissions as well as the more efficient use of energy and other natural resources;

- Governance The Company s governance structure and core principles enable sustainable growth while advancing shareholder value through strong relationships with members, customers, and other stakeholders; and

- Culture and Community Woodward is dedicated to the development of our members and our local communities, and seeks to promote collaborative, effective partnerships at all levels of interaction.

Woodward s sustainability report outlines our present and future commitment to sustainability. Our sustainability report is available on our website and can be accessed by clicking on Our Company and then on Social Responsibility.

INDEPENDENT DIRECTORS

The Board, during its annual review of the independence of its members, has determined that each member of the Board, other than Mr. Gendron, is independent under the criteria established by current NASDAQ listing requirements for independent directors. In addition, the Board has determined that each member of the Audit Committee and each member of the Compensation Committee meets the additional independence criteria required for audit committee and compensation committee members, as applicable, established by SEC rules and regulations and NASDAQ listing requirements.

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BOARD LEADERSHIP STRUCTURE

Mr. Gendron serves as our Chairman of the Board and Chief Executive Officer. Because one individual serves as both Chairman and CEO, the Board appoints an independent director to serve as Lead Director. Our Lead Director is Mr. Cohn, who was appointed to that position by the Board in 2017. The Board recently adopted a Lead Director charter that provides a clear and formal delineation of the duties and responsibilities of the Lead Director. The independent Lead Director, among other duties, chairs separate executive sessions of the independent directors following regularly scheduled Board meetings. The duties and responsibilities of the Lead Director are more fully set forth under the Board Meetings and Committees Lead Director section below. The Board believes the combined Chairman/CEO position, together with an independent Lead Director, has certain advantages over other board leadership structures and best meets the Company s current needs. Mr. Gendron s leadership as Chairman and CEO provides our Board with detailed and in-depth knowledge of the Company s strategy, markets, operations and financial condition, and enhances our ability to communicate a clear and consistent strategy to our stockholders, employees and business partners. This leadership structure differentiates the oversight role of the Lead Director and other independent directors from the oversight role of the Chairman/CEO and other management, enabling the Board and the Chairman/CEO to have greater clarity and focus on their respective leadership roles.

The Board is responsible for, among other things, overseeing the management of the business and affairs of the Company; selecting and recommending to stockholders appropriate candidates for election to the Board; reviewing and, where appropriate, approving the business plans, major strategies and financial objectives of the Company; evaluating Board processes and performance and the overall effectiveness of the Board; evaluating the performance of the Company and of senior management; requiring, approving and overseeing the implementation of the Company s succession plans; reviewing compliance with applicable laws and regulations and adopting and overseeing policies of corporate conduct to assure compliance with applicable laws and regulations, a corporate culture that reflects the Company s values, and maintenance of necessary accounting, financial and other controls.

The Board understands there is no single one-size fits all approach to providing Board leadership in the competitive and changing environment in which we operate. The optimal Board leadership structure may vary as circumstances warrant. At present, the Board believes its current structure effectively maintains independent oversight and management. Consistent with our Director Guidelines, the Board reviews and considers whether the positions of Chairman and CEO should be combined or separated as part of a regular review of the effectiveness of the Company s governance structure.

BOARD MEETINGS AND COMMITTEES

The Board met nine times in fiscal year 2018. All directors attended at least 80 percent of the aggregate of the total meetings of the Board and all committees on which they served. Directors are encouraged, but are not required, to attend annual meetings of stockholders. The Company s last annual meeting of stockholders was attended by all directors.

The Board has the following standing committees: Audit Committee; Compensation Committee; Nominating and Governance Committee; and Executive Committee. All actions by committees are reported to the Board at the next regularly scheduled meeting. As part of its ongoing corporate governance review, the Board reviews its assignment of committee memberships annually and made no changes in fiscal year 2018 to those assignments as reported in last year s proxy statement.

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BOARD MEETINGS AND COMMITTEES (continued)

The following table reflects the committee memberships as of the filing date of this proxy statement:

NAME	AUDIT	COMPENSATION	NOMINATING & GOVERNANCE	EXECUTIVE
John D. Cohn				
Paul Donovan				
Eileen P. Drake				
Thomas A. Gendron				
Daniel G. Korte				
Mary L. Petrovich				
James R. Rulseh				
Ronald M. Sega				
Gregg C. Sengstack				
Jonathan W. Thayer				

= Committee Member; = Chair

Audit Committee

The Audit Committee oversees and monitors the Company s accounting and financial reporting processes, including the quality of internal controls over those processes and audits of the Company s financial statements and internal controls over financial reporting. The Audit Committee also assists the Board with overseeing the Company s processes for risk mitigation and with monitoring compliance with laws, regulations and the Company s Code of Business Conduct and Ethics. The Audit Committee is also responsible for reviewing the Company s financial reporting risk exposure and the Company s risk assessment and risk management processes. In addition, the Audit Committee oversees compliance of the Company s financial statements with applicable rules and regulations and recommends to the Board, based on reviews and discussion with management and the Company s independent registered public accounting firm, that the audited financial statements of the Company be included in the Company s Annual Report on Form 10-K. The Audit Committee also retains, oversees, and evaluates the Company s independent registered public accounting firm, and is involved in the selection of the lead audit partner. The Audit Committee also reviews and approves the selection and tenure of the Company s internal audit lead, and periodically assesses the quality of internal audit activity. The Audit Committee operates under a charter that more fully describes the responsibilities of the Audit Committee. The Audit Committee reviews its charter at least annually and recommends to the Board such revisions as it deems necessary or appropriate. The Audit Committee charter is available at http://www.woodward.com/Charter-Audit-Committee.

Consistent with SEC rules and regulations and NASDAQ s listing standards, and in accordance with the Audit Committee charter, all members of the Audit Committee are independent directors, and meet all enhanced independence requirements for Audit Committee members. The Board of Directors determined that Messrs. Sengstack and Thayer are audit committee financial experts, within the meaning of Item 407(d) of Regulation S-K under the

Securities Act of 1933, as amended, and have experience resulting in financial sophistication as defined under NASDAQ listing requirements.

The Audit Committee meets as often as necessary to perform its duties and responsibilities.

The Audit Committee held six meetings in fiscal year 2018.

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BOARD MEETINGS AND COMMITTEES (continued)

Compensation Committee

The Compensation Committee discharges the responsibilities of the Board relating to compensation of the Company s Chief Executive Officer and other executive officers, conducts an annual performance review of the Chief Executive Officer with input from the independent members of the Board, produces the annual report required by SEC rules, and recommends to the Board the inclusion of the Compensation Discussion and Analysis (CD&A) in the Company s Annual Report on Form 10-K and its proxy statement. The Compensation Committee reviews and approves the compensation of all of our executive officers. The Compensation Committee has oversight responsibility for the Company s annual and long-term incentive plans, which includes Woodward s Cash Long-Term Incentive Plan (the Cash LTI), and the Omnibus Incentive Plan (as may be amended from time to time). Except as described under the Delegation of Authority section, the Compensation Committee determines and takes all action, including granting of all incentives and/or stock options to eligible recipients, in accordance with the terms of the plans, and serves as administrator of the plans and oversees compliance with the terms of the plans. The Compensation Committee reviews performance against targets for both the annual incentive compensation plan and the long-term incentive compensation plan. The Compensation Committee s written charter, which describes the specific duties of the Compensation Committee, is available at http://www.woodward.com/Charter-Compensation-Committee.

Consistent with NASDAQ s listing requirements, and in accordance with the Compensation Committee charter, all members of the Compensation Committee are independent directors and meet the heightened standards for independence of Compensation Committee members under the NASDAQ listing rules. The Compensation Committee charter provides that the Compensation Committee may, after reviewing certain specified independence criteria, retain or obtain the advice of compensation advisers. The Compensation Committee charter also provides that the Compensation Committee is responsible for the appointment, compensation and oversight of the work of any such compensation advisers, and that the Company will provide for appropriate funding for payment of reasonable compensation to any compensation advisers retained by the Compensation Committee.

The Compensation Committee meets as often as necessary to perform its duties and responsibilities. The Compensation Committee held four meetings in fiscal year 2018.

In making its decisions and completing its annual review of our executive compensation program, the Compensation Committee routinely examines a variety of factors which typically include the following (among others):

- Financial reports on performance versus budget and compared to prior year performance for purposes of establishing any payouts under the WVIP;

- Calculations and reports on levels of achievement of corporate performance objectives in the WVIP;

Reports on the Company s strategic initiatives and budget for future performance periods;

Information on the Company s officers and directors stock ownership and option holdings;

Information regarding dilutive effects of the equity compensation plans;

Data regarding the total compensation of our Chief Executive Officer, Chief Financial Officer, and our three other most highly compensated executive officers (our Named Executive Officers, or NEOs), including base salary, cash incentives, equity awards, and any perquisites;

Information regarding compensation programs and compensation levels at our peer comparator group identified by our compensation consultant and described under the caption Compensation Discussion and Analysis Compensation Philosophy and Strategy Competitive Comparisons ;

The extent to which executive compensation and Company performance are aligned;

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BOARD MEETINGS AND COMMITTEES (continued)

- Trends, best practices and regulatory changes that impact executive compensation; and
- The design and administration of the Company s compensation programs and equity compensation plans, and associated risks, if any.

Delegation of Authority

The Compensation Committee charter provides authority to the Compensation Committee to delegate its role and responsibilities to subcommittees entirely made up of Compensation Committee members. The Compensation Committee delegated to the Chairman of the Compensation Committee the authority to approve any and all option exercises when the optionee seeks to pay for the cost of the option and/or the taxes associated with the transaction with stock previously owned and held by the optionee for at least six months. The Chairman of the Compensation Committee is authorized to further delegate these responsibilities to any other member of the Compensation Committee. The Compensation Committee also delegated, to a subcommittee comprised of the Compensation Committee Chairperson and one other Compensation Committee member, the authority to review and approve the grant of options, restricted stock units and/or restricted stock to officers and other employees of the Company, members of the Board, or consultants of the Company in the interval between regularly scheduled meetings of the Compensation Committee, subject to the pool for awards as identified and approved by the Compensation Committee in advance on an annual basis (such grants, interim grants). Additionally, the Board has (i) delegated to the Chief Executive Officer the authority make certain interim grants and (ii) delegated to the Compensation Committee all of the Board s rights to impose restrictions on such authority of the Chief Executive Officer. In accordance with such delegation by the Board, the Compensation Committee has prohibited the Chief Executive Officer from making interim grants to any member of the Board, any Section 16 officer, or any other elected officer of the Company, and has placed limits on the size of any interim grant the CEO may award to any single individual.

Risk Assessment

The Compensation Committee regularly reviews the Company s compensation policies and practices, and believes they are robust and effective. The Company also conducted a review of its compensation plans and related risk to the Company. The Company and the Compensation Committee, with the input of Aon, the Company s compensation consultant, have concluded that any risks arising from its employee compensation policies and practices are not reasonably likely to have a material adverse effect on the Company.

Nominating and Governance Committee

The Nominating and Governance Committee recommends qualified individuals to fill any vacancies on the Board, develops and administers the Director Guidelines and the Company s guidelines for corporate governance, establishes other guidelines, such as stock ownership guidelines for officers and directors, reviews and reassesses the Company s programs and policies related to its codes of conduct, oversees an annual Board self-evaluation, and addresses other governance related matters. In addition, the Nominating and Governance Committee periodically evaluates the compensation and benefits of the Company s non-employee members of the Board and recommends any changes to the Board for approval.

In accordance with NASDAQ listing requirements and the Nominating and Governance Committee s charter, all members of the Nominating and Governance Committee are independent directors. The Nominating and Governance Committee meets as often as necessary to perform its duties and responsibilities. The Nominating and Governance Committee held five meetings in fiscal year 2018. The Nominating and Governance Committee charter is available at http://www.woodward.com/Charter-Nominating-and-Governance-Committee.

Executive Committee

The Executive Committee exercises all the powers and authority of the Board in the management of the business when the Board is not in session, and when, in the opinion of the Chairman of the Board, a particular

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BOARD MEETINGS AND COMMITTEES (continued)

matter should not be postponed until the next regularly scheduled Board meeting. The Executive Committee may declare cash dividends. The Executive Committee may not authorize certain major corporate actions such as amending the certificate of incorporation, amending the bylaws, adopting an agreement of merger or consolidation, or recommending the sale, lease, or exchange of substantially all of the assets of the Company. The Executive Committee meets as often as necessary to perform its duties and responsibilities. The Executive Committee held no meetings in fiscal year 2018. The Executive Committee charter is available at http://www.woodward.com/Charter-Executive-Committee.

Director Nomination Process

The Nominating and Governance Committee considers candidates for Board membership as recommended by directors, management, or stockholders. The Nominating and Governance Committee uses the same criteria to evaluate all candidates for Board membership, whether recommended by directors, management, or stockholders. As it deems necessary, the Nominating and Governance Committee may engage consultants or third-party search firms to assist in identifying and evaluating potential nominees.

The Nominating and Governance Committee recommends qualified director candidates for nomination by the Board based on the skills and characteristics that the Board seeks in its members as well as consideration of the diversity of the Board as a whole. This review includes an assessment of, among other things, a candidate s knowledge, education, experience, cultural background, including race, gender and age, and skills in areas critical to understanding the Company and its business, with a commitment to enhancing shareholder value. The Nominating and Governance Committee seeks candidates with the highest professional and personal ethics and values, that are aligned with the philosophy and concepts as expressed in the Company s Constitution, and who will operate in accordance with the Company s Code of Business Conduct and Ethics. The Nominating and Governance Committee also assesses a candidate s ability to make independent analytical inquiries, and willingness to devote adequate time to Board duties.

Director nominees should possess the following experience, qualifications, attributes and skills:

- An understanding of the principal operational and financial objectives, plans and strategies of the Company;
- An understanding of the results of operations and financial condition of the Company;
- An understanding of the relative standing of the Company in relation to its competitors; and
- Leadership experience at the policy-making level in business, government, education or public interest.

Prospective directors should be committed to representing the long-term interests of the stockholders. A potential director must exhibit an inquisitive and objective perspective, an ability to think strategically, an ability to identify practical problems, and an ability to assess alternative courses of action that contribute to the long-term success of the business. Director candidates must have industry expertise and/or commit to understanding the Company s industry as a basis to address strategic and operational issues of importance to the Company. Directors are also expected to commit substantial time and energy to the Board and should ensure that other existing and future time commitments do not materially interfere with their service as a director. Directors shall limit their service to a maximum of four other public companies, and in the case of employee directors, to one other public company.

The Nominating and Governance Committee considers other relevant factors, as it deems appropriate, including the current composition of the Board and the need for expertise on various Board committees. Every effort is made to complement and supplement skills within the Board and strengthen identified areas of need. The Nominating and Governance Committee considers the ability of candidates to meet independence and other requirements of the SEC, NASDAQ, or other regulatory bodies exercising authority over the Company. Under the Director Guidelines, no individual will be nominated by the Board for re-election if such individual will

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BOARD MEETINGS AND COMMITTEES (continued)

achieve the age of 70 as of the annual stockholder meeting date of such re-election, unless the Board determines in its sole discretion that extraordinary circumstances exist that would support any such nomination. Additionally, directors whose professional responsibilities change significantly from those they had when they were elected to the Board or who are involved in other circumstances that may negatively impact the Board or the Company should volunteer to resign from the Board. Such persons should not necessarily leave the Board. There should, however, be an opportunity for the Board through the Nominating and Governance Committee to review the continued appropriateness of Board membership under the circumstances.

The Nominating and Governance Committee s process for evaluating potential director candidates normally requires one or more members of the Nominating and Governance Committee, and others as appropriate, to interview prospective nominees in person or by telephone. Upon identification of a qualified candidate, the Nominating and Governance Committee will recommend a candidate for consideration by the full Board.

Stockholders wishing to suggest a candidate for Board membership should write our Corporate Secretary at 1081 Woodward Way, Fort Collins, Colorado 80524, and provide certain information to the Company as follows:

- The stockholder s name and contact information;
- A statement that the writer is a stockholder of record and is proposing a candidate for consideration by the Nominating and Governance Committee;
- The name of, and contact information for, the candidate and a statement that the candidate is willing to be considered and serve as a director, if nominated and elected;
- A statement of the candidate s business and educational experience;
- Information regarding the factors described above sufficient to enable the Nominating and Governance Committee to evaluate the candidate;
- A statement of the value that the candidate would add to the Board;

A statement detailing any relationship between the candidate and any of our customers, suppliers, or competitors; and

Detailed information about any relationship or understanding between the proposing stockholder and the candidate.

In connection with its evaluation, the Nominating and Governance Committee may request additional information from the candidate or the recommending stockholder. The Nominating and Governance Committee has discretion to decide which individuals to recommend for nomination as directors. In order to give the Nominating and Governance Committee sufficient time to evaluate a recommended candidate, the recommendation must be received by our Corporate Secretary not later than the 120th calendar day before the one year anniversary of the date our proxy statement was mailed to stockholders in connection with the previous year s Annual Meeting of stockholders. No candidates for director nominations were submitted to the Nominating and Governance Committee by any stockholder in connection with the election of directors at this Annual Meeting.

Board Composition and Diversity

The Board meets periodically with the Nominating and Governance Committee to review Board composition for diversity of knowledge, experience, cultural background, race, gender, and age which, when taken together, enables the Board to ensure that board members possess the skills, perspectives and expertise necessary to effectively oversee the Company s business. In this regard, the Nominating and Governance Committee considers, for each incumbent director and potential nominee, the various factors described in the below table. The Nominating and Governance Committee reviews the assessment and its recommendations with the Board.

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BOARD MEETINGS AND COMMITTEES (continued)

The Nominating and Governance Committee is committed to exercising best practices of corporate governance and recognizes the importance of a Board that contains diverse experience at policy-making levels in business, public service, education, and technology, as well as other relevant knowledge that contributes to the Company s global activities. The Board believes that diversity is an important component of Board membership, and is guided by the Company s Bylaws, Director Guidelines, and Constitution, which requires the Board to adhere to the philosophy and concepts, including respect for the dignity, value and equality of all members.

Board diversity, leadership and experience qualifications for our independent directors are summarized in the table below:

BOARD MEMBER	CORPORATE GOVERNANCE		LEADERSHIP EXPERIENCE / COMPLIANCE	INDIVIDUAL DIVERSITY ATTRIBUTES	STRATEGY	INDUSTRY KNOWLEDGE
John D. Cohn	17			64		
Paul Donovan	19	1		71		
Eileen P. Drake	2	1		52		
Thomas A. Gendron	14	1		57		
Daniel G. Korte	2	1		58		
Mary L. Petrovich	17	3		55		
James R. Rulseh	17	1		63		
Ronald M. Sega	11	1		66		
Gregg C. Sengstack	8	1		60		
Jonathan W. Thayer	3			47		

* Including year appointed

Lead Director

In November 2017, Mr. Cohn was appointed to Lead Director. In July 2018, the Board adopted a Lead Director charter to establish a clear and formal delineation of Lead Director duties and responsibilities. The Lead Director chairs separate meetings of the independent directors, generally following each regularly scheduled Board meeting. The Lead Director facilitates discussion and open dialogue among the independent directors. Topics discussed are at the discretion of the independent directors, and generally include among other things, a review of our Chief Executive Officer s performance. The Lead Director then meets with the Chief Executive Officer to review items discussed at the meeting and to provide feedback from the Board with regard to his overall performance as CEO. The Lead Director then reports to the independent directors regarding each such feedback meeting with the Chief Executive Officer. Additionally, the Lead Director (together with the Chairperson of the Compensation Committee) presents to the Chief Executive Officer his annual performance review as conducted by the Compensation Committee with input from the independent members of the Board of Directors, and the Lead Director (together with the Chairperson of the Nominating and Governance Committee) reviews and reports on the results of the Board s annual self-evaluation, discussed below. The Lead Director also

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BOARD MEETINGS AND COMMITTEES (continued)

communicates with the Chief Executive Officer on a regular basis to discuss any other Board matters or concerns, and acts as a liaison in that regard between the independent members of the Board and the Chief Executive Officer, without inhibiting direct communication between them. The charter provides that the Lead Director will serve a maximum term of five years in such capacity.

Board and Board Committees Self-Evaluation Process

Board and committee evaluations play a critical role in ensuring the effective functioning of our Board and Board committees. Our Board annually evaluates the performance of the Board and its committees. As part of the Board s self-assessment process, directors are provided with detailed questionnaires and participate in a guided, interview-based self-evaluation designed to offer a thoughtful and substantive reflection on the Board s performance. The questionnaires and interviews consider various topics related to Board composition, structure, effectiveness and responsibilities, as well as the overall mix of director skills, experience and backgrounds. As set forth in its charter, the Nominating and Governance Committee oversees the Board and committee evaluation process. The Nominating and Governance Committee reviews the questionnaires and the self-evaluation process, considers whether changes are recommended, and reports the results to the Board.

Stockholder Communications With the Board of Directors

Stockholders may send communications to the Board by submitting a letter addressed to: Woodward, Inc., Attn: Corporate Secretary, 1081 Woodward Way, Fort Collins, Colorado 80524. The Board has instructed the Corporate Secretary to forward such communications to the Lead Director. The Board has also instructed the Corporate Secretary to review such correspondence and, at the Corporate Secretary s discretion, not to forward correspondence which is deemed of a commercial or frivolous nature or inappropriate for Board consideration. The Corporate Secretary may also forward the stockholder communication within the Company to the Chief Executive Officer and President or to another executive officer to facilitate an appropriate response.

The Corporate Secretary maintains a log of all communications from stockholders and the disposition of such communications, which the directors review at least annually.

Risk Oversight

The Board is responsible for overseeing management s identification and mitigation of Company risks, including but not limited to risks associated with our strategic plan, capital structure, development activities, compliance with government regulations, and other significant inherent risks such as cybersecurity. The Board has the ultimate oversight responsibility for risk management processes, and various committees of the Board composed entirely of independent directors also have responsibility for some aspects of risk management oversight. While the Board and its various committees have oversight responsibilities for risk management processes, management has responsibility for the day-to-day aspects of risk management. The Board and its committees receive regular reports on risk management from Company management and independent auditors.

The Audit Committee is responsible for risks relating to the Company s financial statements, financial reporting processes, the evaluation of the effectiveness of internal control over financial reporting, and the Company s compliance with its financial and ethics policies.

The Compensation Committee is responsible for monitoring risks associated with the design and administration of the Company s compensation programs and equity compensation plans, and performs the annual performance review of the CEO and ensures the independence of the compensation consultants.

The Nominating and Governance Committee oversees risks relating to the Company s corporate governance processes, compliance with the SEC and NASDAQ rules and regulations, and other state and federal laws and regulations relating to corporate governance, and reviews and reassesses the adequacy of the Company s Code of Business Conduct and Ethics.

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BOARD MEETINGS AND COMMITTEES (continued)

The Board and its committees have direct and independent access to management. We believe this division of risk management responsibilities is the most effective approach for addressing the risks that Woodward faces. The existing Board leadership structure encourages communication between the independent directors and management, including those as a result of discussions between the Lead Director and the Chairman of the Board and Chief Executive Officer. By fostering increased communication, we believe that the current Board leadership structure leads to the identification and implementation of effective risk management strategies.

Related Person Transaction Policies and Procedures

The Board adopted the Company s Related Person Transaction Policies and Procedures (our RPT Policy), which provides that the Audit Committee will review and approve Interested Transactions (as described below). Our RPT Policy delegates the authority to act with respect to Interested Transactions that are valued below a stated threshold to the Chair of the Audit Committee.

Our RPT Policy defines an Interested Transaction with reference to transactions described in Item 404 of Regulation S-K promulgated by the SEC, which generally means a transaction, arrangement or relationship (including any indebtedness or guarantee of indebtedness) or any series of similar transactions, arrangements or relationships or any material amendments or modifications thereto in which the Company (including any of its subsidiaries) was, is, or will be a participant and the amount involved exceeds $120,000, and in which any Related Person had, has, or will have a direct or indirect interest.

Related Person also is defined in our RPT Policy with respect to the definitions contained in Item 404 of Regulation S-K. Generally, Related Persons consist of any director or executive officer of the Company, any nominee for director, any holder of five percent or more of the Company s common stock, or any immediate family member of any such persons. Immediate family member means any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law of any such person, and any person (other than a tenant or employee) sharing the household of such person. It may also include entities with which any of such persons have a relationship.

The approval procedures in our RPT Policy state that the Audit Committee will take into account, among other factors it deems appropriate, whether the Interested Transaction is on terms no less favorable than terms generally available to an unaffiliated third-party under the same or similar circumstances. In addition, our RPT Policy states that, in connection with the approval or ratification of an Interested Transaction involving an outside director or nominee for director, the Audit Committee should consider whether such transaction would compromise such director s status as: (1) an independent director under NASDAQ s independence standards, (2) an outside director under Section 162(m) of the Internal Revenue Code (the Code) or a non-employee director under Rule 16b-3 under the Exchange Act, if such non-employee director serves on the Compensation Committee of the Board, or (3) an independent director under Rule 10A-3 of the Exchange Act, if such non-employee director serves on the Audit Committee of the Board. Our RPT Policy also identifies certain transactions that are deemed to be pre-approved, including transactions involving competitive bids, regulated transactions, and employee transactions. No director participates in any discussion for approval of a related party transaction for which he or she is an interested party other than is necessary to provide relevant information to the Audit Committee. Our RPT Policy is available at http://www.woodward.com/Related-Person-Transaction-Policy.

Woodward is not currently engaged in any Interested Transactions.

Compensation Committee Interlocks and Insider Participation

Ms. Petrovich and Messrs. Rulseh, Cohn, and Donovan served as members of the Compensation Committee during fiscal year 2018. The Compensation Committee members have no interlocking relationships required to be disclosed under SEC rules and regulations.

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BOARD MEETINGS AND COMMITTEES (continued)

Director Compensation

We do not pay directors who are also Woodward employees additional compensation for their services as directors. Non-employee directors are paid cash compensation for their service on the Board, as well as additional cash compensation for any memberships and/or chair positions on various Board committees or as Lead Director. Additionally, non-employee directors are awarded equity compensation (in the form of stock options) based on an targeted delivered value as recommended by the Nominating and Governance Committee and approved by the Board, following consultation with and recommendations from Aon. For this purpose, delivered value means the total Black-Scholes value on the day prior to the effective date of the grant. The exercise price of the stock option awards is determined on the effective grant date and is not less than (and is typically equal to) the closing price of the Company s stock as quoted on NASDAQ on that day. For fiscal year 2018, based on Board approval of targeted delivered value, the Compensation Committee approved the grant of stock options to non-employee directors on September 29, 2017 at an exercise price of $78.97, which was the closing price of Woodward common stock as quoted on NASDAQ on the effective grant date (October 2, 2017).

As set forth in our Omnibus Incentive Plan, however, no non-employee director may receive equity awards in any fiscal year (the value of which will be based on their grant date fair value determined in accordance with Generally Accepted Accounting Principles) that, in the aggregate, exceed $300,000, provided that such amount is increased to $450,000 in the fiscal year of a non-employee director s initial appointment. The number of stock options awarded to each director is based on the intended delivered value, divided by the Black-Scholes value of a stock option as calculated by Aon for all stock option participants in a given year.

The Nominating and Governance Committee evaluates the market competitiveness of the Company s Board of Director compensation program every two years. Accordingly, as established in its calendar, the Nominating and Governance Committee commissioned Aon to conduct a competitive assessment in September 2017 of the Company s Board of Director compensation program relative to market practice. Aon analyzed Board of Director compensation practices for the Company s peer group, as defined in the Compensation Discussion and Analysis discussed below, and compared Woodward s Board compensation program at the time to market practice. Based on the results of the competitive assessment, the Nominating and Governance Committee determined it was appropriate to increase Board cash compensation effective October 1, 2017, for fiscal year 2018, to more closely align to market levels.

Cash compensation for non-employee directors was as follows in fiscal year 2018:

Annual Retainer (1)	$75,000
Additional Annual Retainer Fees	
Lead Director	$12,500
Audit Committee Chairman	$23,000

Audit Committee Non-Chair members	$13,000
Compensation Committee Chairman	$12,500
Compensation Committee Non-Chair members	$6,500
Nominating & Governance Committee Chairman	$12,500
Nominating & Governance Committee Non-Chair members	$6,500

(1) Annual, Lead Director and Committee membership retainers are paid in four equal quarterly installments. Directors do not receive additional compensation for individual Board or Committee meetings held.

Our directors are eligible to participate in a non-qualified deferred compensation plan, the Woodward Executive Benefit Plan (EBP). Under the EBP, our directors are able to defer up to 100% of their cash

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BOARD MEETINGS AND COMMITTEES (continued)

compensation, including retainer fees, and any fees for participation as a committee member, committee chairman, or Lead Director.

The following table shows the compensation earned by non-employee members of the Board during the fiscal year ended September 30, 2018:

DIRECTOR	FEES EARNED OR PAID IN CASH ($)	OPTION AWARDS ($)(1)	TOTAL ($)
John D. Cohn	98,875	186,409	285,284
Paul Donovan	88,000	186,409	274,409
Eileen P. Drake	88,000	186,409	274,409
John A. Halbrook(2)	37,500	186,409	223,909
Daniel G. Korte	88,000	186,409	274,409
Mary L. Petrovich	94,000	186,409	280,409
James R. Rulseh	95,625	186,409	282,034
Dr. Ronald M. Sega(3)	88,000	186,409	274,409
Gregg C. Sengstack	98,000	186,409	284,409
Jonathan W. Thayer	88,000	186,409	274,409

(1) Under our Omnibus Incentive Plan, on October 2, 2017, each non-employee director was awarded options to purchase 6,000 shares of Woodward common stock at $78.97 per share, the closing price of Woodward common stock on that date as quoted on NASDAQ. Each option tranche vests at the rate of 25% per year generally, assuming continued service on the Board. The amounts reported in the Option Awards column above represent the grant date fair value of the option awards as calculated under generally accepted accounting principles in accordance with Accounting Standards Codification 718. Assumptions used in calculating these amounts are included in Note 19 of Woodward s financial statements in its Annual Report on Form 10-K for the fiscal year ended September 30, 2018 filed with the SEC on November 9, 2018.

(2) Mr. Halbrook retired from the Board on January 24, 2018 and the fees shown reflect payment for the portion of the year he served as a Director.

(3) Dr. Sega deferred 100% of his cash retainer fees in fiscal year 2018 into the EBP.

Option awards outstanding as of September 30, 2018 are as follows:

DIRECTOR	OPTIONS NOT VESTED	OPTIONS VESTED	OPTIONS OUTSTANDING
John D. Cohn	17,550	42,045	59,595
Paul Donovan	17,550	34,445	51,995
Eileen P. Drake	8,625	875	9,500
John A. Halbrook	17,550	45,845	63,395
Daniel G. Korte	8,625	875	9,500
Mary L. Petrovich	17,550	42,045	59,595
James R. Rulseh	17,550	23,220	40,770
Dr. Ronald M. Sega	17,550	42,045	59,595
Gregg C. Sengstack	17,550	28,245	45,795
Jonathan W. Thayer	11,250	1,750	13,000

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STOCK OWNERSHIP OF MANAGEMENT

Directors and Named Executive Officers

The following table shows how much Woodward common stock was beneficially owned, as of November 26, 2018, by each director, each named executive officer of the Company, and all directors and executive officers as a group:

DIRECTORS	NUMBER OF SHARES (1)(2)	PERCENT (%)(1)
John D. Cohn	69,195	*
Paul Donovan(3)	82,963	*
Eileen P. Drake	2,375	*
Daniel G. Korte	2,375	*
Mary L. Petrovich	73,102	*
James R. Rulseh	40,370	*
Ronald M. Sega	57,785	*
Gregg Sengstack	59,395	*
Jonathan W. Thayer	5,000	*
NAMED EXECUTIVE OFFICERS		
Thomas A. Gendron	1,587,932	2.48
Robert F. Weber, Jr.	293,647	*
A. Christopher Fawzy	158,463	*
Sagar A. Patel	178,317	*
Chad R. Preiss(4)	243,318	*
All directors and executive officers as a group (15 persons)	2,958,329	4.61

**Less than one percent*

(1) The number of shares outstanding for purposes of calculating the percentages shown includes shares (does not include fractional shares) allocated to participant accounts of named executive officers under the Woodward Retirement Savings Plan (the Retirement Savings Plan), as well as the EBP. The Retirement Savings Plan directs the Trustee to vote the Woodward shares allocated to participants accounts as directed by such participants. If voting instructions are not received, the Trustee is instructed to vote the shares held in the Plan in the same proportion as the shares for which the Trustee has received instructions.

(2) In addition, the number of shares outstanding for purposes of calculating the percentages shown includes a number of shares of our common stock that may be acquired by each person referenced through the exercise of options within 60 days of November 26, 2018 in accordance with the rules of the SEC. The below table summarizes all shares that may be acquired through the exercise of options within 60 days of November 26,

2018.

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STOCK OWNERSHIP OF MANAGEMENT (continued)

Table to footnote (2) above:

DIRECTORS	NUMBER OF SHARES
John D. Cohn	49,195
Paul Donovan	41,595
Eileen P. Drake	2,375
Daniel G. Korte	2,375
Mary L. Petrovich	49,195
James R. Rulseh	30,370
Ronald M. Sega	49,195
Gregg Sengstack	35,395
Jonathan W. Thayer	5,000
NAMED EXECUTIVE OFFICERS	
Thomas A. Gendron	1,223,200
Robert F. Weber, Jr.	239,700
A. Christopher Fawzy	146,950
Sagar A. Patel	166,025
Chad R. Preiss	181,450

(3) Includes 1,231 shares held by Mr. Donovan s wife. Mr. Donovan disclaims beneficial ownership of the shares held by his wife.

(4) Includes 6,400 shares held by Mr. Preiss wife and 700 shares held in trust for the benefit of a minor child.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based upon a review of our records, all reports required to be filed pursuant to Section 16(a) of the Securities Exchange Act of 1934 (the Exchange Act) were filed on a timely basis, with the exception of a Form 4 filed by the Company on behalf of Mr. Rulseh related to a single sale of Company stock. The untimely Form 4 was filed outside the Section 16 filing requirement and was primarily due to an administrative oversight by the transaction broker.

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PERSONS OWNING MORE THAN FIVE PERCENT OF WOODWARD STOCK

The following table shows how many shares of Woodward common stock were owned by each person known to us to own more than five percent of our common stock as of November 26, 2018:

OWNERSHIP OF COMMON STOCK

PRINCIPAL HOLDERS	NUMBER OF SHARES	PERCENT (%)
BlackRock, Inc. 55 East 52nd Street New York, New York 10055	5,590,344(1)	9.04
The Vanguard Group 100 Vanguard Boulevard Malvern, Pennsylvania 19355	4,600,889(2)	7.44
Woodward Retirement Savings Plan 5001 North Second Street Rockford, IL 61111	4,268,113(3)	6.90

(1) Based solely on a Schedule 13G filed with the SEC by BlackRock, Inc. (BlackRock) on January 23, 2018. BlackRock has sole voting power with respect to 5,464,756 shares of our common stock and sole dispositive power with respect to 5,590,344 shares of our common stock.

(2) Based solely on a Schedule 13G filed with the SEC by The Vanguard Group, Inc. (Vanguard) on February 7, 2018. Vanguard has sole voting power with respect to 103,803 shares of our common stock, has shared voting power with respect to 7,326 shares of our common stock, has sole dispositive power with respect to 4,493,790 shares of our common stock, and has shared dispositive power with respect to 107,099 shares of our common stock. Of the 4,600,889 total shares of our common stock held by Vanguard, Vanguard Fiduciary Trust Company, a wholly-owned subsidiary of Vanguard, is the beneficial owner of 99,773 shares of our common stock as a result of its serving as investment manager of collective trust accounts. Vanguard Investments Australia, Ltd., a wholly-owned subsidiary of Vanguard, is the beneficial owner of 11,356 shares of our common stock as a result of its serving as investment manager of Australian investment offerings.

(3) Based solely on a Schedule 13G filed with the SEC by Woodward Retirement Savings Plan (the Retirement Savings Plan) on February 12, 2018. Shares in the Retirement Savings Plan are held in a trust for which Vanguard Fiduciary Trust serves as Trustee. JPMorgan Chase Bank, N.A. serves as custodian of the Retirement Savings Plan and holds the actual shares in a custodial account. All shares held in the Retirement Savings Plan are allocated to participant accounts. The Retirement Savings Plan has sole voting power and sole dispositive power with respect to 4,268,113 shares of our common stock. However, the Retirement Savings Plan directs the Trustee to vote the shares allocated to participant accounts under the Woodward Stock Plan portion of the Retirement Savings Plan as directed by such participants and to vote all allocated shares for which no timely instructions are received in the same proportion as the allocated shares for which instructions are received.

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COMPENSATION DISCUSSION AND ANALYSIS

The following Compensation Discussion and Analysis (CD&A) provides an overview of our compensation philosophy, strategy, objectives and structure for fiscal year 2018. This section is intended to be read in conjunction with the tables that immediately follow, which provide further historical compensation information for the NEOs.

For fiscal year 2018, our NEOs were:

NAME	PRINCIPAL POSITION
Thomas A. Gendron	Chairman, Chief Executive Officer and President
Robert F. Weber, Jr.	Vice Chairman, Chief Financial Officer and Treasurer
A. Christopher Fawzy	Corporate Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer
Sagar A. Patel	President, Aircraft Turbine Systems
Chad R. Preiss	President, Industrial Control Systems

Executive Summary

Our executive compensation program has been designed to (1) provide a competitive total compensation program that enables us to attract, retain, and motivate a high-performance executive management team, and (2) link the total compensation program payouts to Company and stockholder interests. We believe that proper administration of this program should result in a compensation program that is aligned with, and motivates improvement in, our fundamental financial performance and supports the long-term interests of the Company and its stockholders.

Our executive compensation program is based on the overall financial performance of the Company and is structured as a total compensation package comprised of the following elements:

- Base salary;
- Annual short-term incentive compensation under the Woodward Variable Incentive Plan (WVIP); and
- Long-term incentive compensation under the Company s long-term incentive program (LTI Plan), which includes a cash component (under the Cash LTI, as discussed below) and equity components (non-qualified stock options).

In addition, the executive compensation program for NEOs includes health and welfare benefits, a deferred compensation program, defined contribution plans, change in control agreements, and other ancillary benefits.

On November 7, 2018, we reported our financial results for fiscal year 2018, which included the following highlights:

Net sales for fiscal year 2018 of $2.326 billion, an increase of 11% compared to $2.098 billion in fiscal year 2017.

Net earnings for fiscal year 2018 of $180.4 million, or $2.82 per diluted share, compared to $200.5 million, or $3.16 per diluted share, in fiscal year 2017.

The net earnings results are reflected in the compensation paid in fiscal year 2018, particularly through the WVIP.

Executive Compensation Mix

For our NEOs, we believe it is important to provide a significant portion of total compensation tied to incentives that can fluctuate, up or down, based on our financial and operational performance to align with stockholder interests. With respect to variable compensation, the Compensation Committee places a balanced emphasis on both short term (i.e., the WVIP) and long-term Company performance (i.e., Cash LTI and equity compensation); however, the majority of target variable compensation for our NEOs is attributable to long-term objectives.

In analyzing the pay mix and various elements of compensation for each NEO, the Compensation Committee annually considers competitive market data; internal equity (the relative compensation among the Company s NEOs); and the other individual factors described below in Compensation Philosophy and Strategy, including the nature and scope of the individual s role at Woodward, the individual s performance, knowledge, skills, abilities, potential, and overall contribution to the Company and impact to shareholder value.

The charts below reflect the target mix pay between fixed and variable compensation components based on FY18 target compensation for our NEOs during fiscal year 2018, which reflects our pay-for-performance philosophy:

Compensation Philosophy and Strategy

Our compensation philosophy and strategy is to establish total compensation (base salary, annual short-term cash incentives, and long-term incentives) for each NEO that is competitive with total compensation for executives in comparable positions at companies in our peer comparator group. Our compensation approach reflects multiple factors such as (i) the individual s performance, knowledge, skills, abilities, potential, (ii) significant contributions to the Company and impact to shareholder value, and (iii) our ability to achieve our goals to attract and retain industry leading talent.

Our philosophy places a strong focus on pay-for-performance, with an emphasis on variable compensation, and in particular, long-term incentive compensation that directly ties to Company performance. Our variable compensation plans (annual short-term incentives and long-term incentives), which for fiscal year 2018 represented between 66% and 84% of our NEOs target total compensation opportunities, are designed so that the payout opportunity is directly linked to the achievement of pre-determined financial performance metrics, with upside opportunity for exceeding the pre-determined goals. Our variable compensation plans also include equity-based compensation to align NEO and stockholder interests. With the variable incentive components of our executive compensation program, we strive to align the interests of the NEOs with the interests of our stockholders in different ways by focusing on both short-term and long-term performance goals, by promoting ownership of the Company, and by linking reward outcomes to our financial performance. As a result of Woodward s total compensation approach, which includes base pay and variable pay (annual incentive

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compensation and long-term incentive compensation), the actual performance of the Company significantly influences the total compensation received by our NEOs.

Consideration of Stockholder Say on Pay Vote

In January 2018, our stockholders voted on an advisory resolution regarding the compensation of our named executive officers, which was approved by 97.2% of the votes cast on the proposal (the say on pay proposal). The Compensation Committee determined the 97.2% favorable vote demonstrated strong stockholder support for Woodward s overall executive compensation approach and the related actions described in its 2017 proxy statement, and further determined that current practices and processes did not require any significant modifications to achieve the desired results or to address any stockholder concerns. In addition, at the 2016 Annual Meeting held in January 2017, our stockholders indicated their preference for an annual say on pay vote in an advisory resolution regarding the frequency of say on pay proposals, which the Board adopted. Accordingly, a say on pay proposal is again being submitted to our stockholders for consideration at the 2018 Annual Meeting, which is included as Proposal 3 in this proxy statement. The Compensation Committee will continue to consider the outcome of these advisory votes when evaluating future executive compensation arrangements.

The Compensation Committee s Interaction with Management

In order to design compensation programs that are aligned with appropriate Company performance goals and strategic direction, the Compensation Committee works closely with management, including the Chief Executive Officer, the Corporate Vice President, Human Resources, and the Corporate Vice President, General Counsel & Corporate Secretary. Specifically, management facilitates the alignment process by:

- Reviewing compensation data of our NEOs, which is provided by our executive compensation consultant for comparative benchmarking;
- Evaluating NEO performance (with the exception of our Chief Executive Officer);
- Making recommendations to the Compensation Committee regarding annual short-term incentive plan design and performance metrics; and
- Making recommendations to the Compensation Committee regarding the compensation of the NEOs (with the exception of the Chief Executive Officer) for base salary, annual short-term incentive compensation targets, long-term cash incentive compensation targets, and long-term equity compensation. The Chief Executive

Officer s compensation, including base salary, is determined by the Compensation Committee, with guidance from our compensation consultant, relative to comparative market data, as well as by measuring his performance against a defined process led by the Compensation Committee Chairman involving all independent Board members.

All decisions regarding executive compensation are ultimately made by the Compensation Committee.

The Company s Corporate Vice President, Human Resources, works with the Compensation Committee Chair to establish the agenda for Compensation Committee meetings. At the Compensation Committee s request, the Chief Executive Officer regularly attends the meetings and provides background information regarding the Company s strategic objectives, evaluation of the performance of the executive officers, and compensation recommendations as to executive officers other than himself. The Compensation Committee may also seek input from the Corporate Vice President, General Counsel & Corporate Secretary, as necessary and appropriate, to carry out its duties. The Corporate Vice President, Human Resources, provides input on executive compensation structure, performance assessment process and data, potential promotions, talent management and succession planning, and compensation associated with promotions. No employee is present during the discussion of his or her compensation.

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

Interaction with Compensation Consultants

In making its determinations with respect to executive compensation, the Compensation Committee generally engages the services of an independent compensation consultant. In fiscal year 2018, the Compensation Committee retained the services of Aon to assist with its review of the total compensation packages of the NEOs.

The Compensation Committee retains Aon primarily to provide guidance for the executive compensation decision-making process. Annually, Aon provides the Compensation Committee with an analysis comparing the compensation for the NEOs to our compensation philosophy and to the data of our peer comparator group for base salary, target short-term incentives, target total cash, target long-term incentives (cash and equity), and target total compensation. In carrying out its assignment, the consultant may interact with members of management, including but not limited to the Chief Executive Officer, the Corporate Vice President, Human Resources, the Corporate Vice President, General Counsel & Corporate Secretary, and the Vice President & Corporate Controller.

In addition to their services with respect to compensation for the NEOs, Aon acts as a global compensation and benefits consultant for the Company and provides total compensation data for the Company s key leadership group. Management also utilizes Aon s benefits index and compensation and benefits survey data to benchmark compensation and benefits for the Company s non-NEOs.

During fiscal year 2018, in accordance with SEC rules and regulations and NASDAQ listing requirements, the Compensation Committee considered various factors relating to compensation consultant independence, including the following six factors established by the SEC:

- The provision of other services to the Company by Aon;
- The amount of fees received from the Company by Aon as a percentage of total revenue;
- Aon s policies and procedures designed to prevent conflicts of interest;
- Any business or personal relationship of the individual consultants with a member of the Compensation Committee;
- Any stock of the Company owned by the individual consultants; and

Any business or personal relationship of the individual consultants or Aon with an executive officer of the Company.

As a result of the interactions with the Compensation Committee and management, the Company believes Aon has a well-developed understanding of our business, and is well positioned to provide objective guidance on compensation and benefit plans that are aligned with and reinforce our strategies and goals, and has determined that Aon is independent and free from any conflict of interest.

Compensation Consultant Fees

For fiscal year 2018, the Company paid Aon $829,628 for advice and services provided to the Compensation Committee and the Company. Of this amount, $445,551 was paid as a result of the work Aon performed for the Compensation Committee related to executive compensation advice and services, and $384,077 was paid as a result of the work Aon performed for the Company that was not related to executive compensation, including broad compensation benchmarking data applicable to non-executive employees, including international benchmarking data and services, and other health, welfare and retirement plan consulting services.

The decision to use Aon for advice and services not related to executive compensation was made by management. While neither the Compensation Committee, nor the Board pre-approves these non-executive compensation services, the Compensation Committee annually reviews Aon s internal guidelines and practices

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designed to guard against conflicts and ensure the objectivity of advice in connection with the Compensation Committee s review of the six compensation consultant conflicts of interest factors described above under Interaction with Compensation Consultants.

The Compensation Committee believes that the advice and services unrelated to executive compensation that Aon provided to the Company did not impact advice and services that Aon provided to the Compensation Committee on executive compensation matters nor the independence of Aon with respect to management.

Competitive Comparisons

Our executive compensation program is benchmarked to be competitive with our peer comparator group. On an annual basis, companies in our peer comparator group are approved by the Compensation Committee. The companies included in our peer comparator group are selected from the Aon Total Compensation Measurement database on the basis of competition for business or talent, global and publicly-traded holding structure, level of operational complexity, similar revenue size, market capitalization, markets and industries served, and manufacturing profile.

Based on its annual review, effective for fiscal year 2018, the Compensation Committee determined it was appropriate to make changes to the companies comprising the peer group for pay and performance comparisons. Accordingly, CLARCOR, Inc., Roper Technologies, Inc., Valmont Industries, Inc., and Kaman Corporation were removed from the peer group. CLARCOR was removed due to its acquisition by Parker Hannifin. Roper Technologies, Valmont Industries, and Kaman Corporation were removed based on a difference in business operations and strategy, markets served, and/or customers relative to Woodward. Nordson Corporation and Hexcel Corporation were added to the peer group as a result of being similar in size (as measured by revenues, market capitalization and profitability), scope of operations, markets served, and customers. Based on the changes made effective for fiscal year 2018, the Compensation Committee determined that the composition of the revised peer group, as well as the number of companies comprising the revised peer group, was appropriate to benchmark competitive compensation levels and performance.

Compensation data from our peer comparator group identified in the table below was reviewed as part of the Compensation Committee s process of determining target total compensation opportunities for each NEO for fiscal year 2018. We also reference this data across each component of compensation for our NEOs, including base salary, annual short-term incentive compensation, and long-term incentive compensation. At the time the peer group below was approved by the Compensation Committee, the peer group was comprised of companies that had revenues equal to 0.6x to 2.6x the Company s revenues which, based on Aon s recommendation, the Compensation Committee determined to be an appropriate range. Revenues served as a key evaluation criteria because we believe that it is a reasonable reflection of the scope and complexity of an organization, as well as the duties and responsibilities of the NEO positions being compared.

FISCAL YEAR 2018 COMPARATOR PEER GROUP

Actuant Corporation	Flowserve Corp.	Moog Inc.
Ametek Inc.	Graco Inc.	Nordson Corporation
Barnes Group Inc.	Hexcel Corporation	Rockwell Collins Inc.
Crane Co.	Hubbell Inc.	Teledyne Technologies, Inc.
Curtiss-Wright Corporation	ITT Corporation	The Timken Company
Donaldson Company, Inc.	Kennametal Inc.	Triumph Group, Inc.
Esterline Technologies Corp.		

In fiscal year 2018, the Compensation Committee continued to use the same approach to competitive data to assess the NEOs compensation levels as that which was used in fiscal year 2017. Accordingly, the Compensation Committee used raw competitive data (as compared to size adjusted data) to establish the

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

competitive market for pay levels due to the increased transparency of raw data for the Compensation Committee and executives, and because it lessens potential volatility in pay levels that can be attributable to small changes in executives revenue responsibilities.

Compensation Decisions Compared to Market Data

When determining total compensation opportunities for our executives, we consider many factors, including:

- our compensation philosophy, which provides guiding principles and broad direction;
- external market data to provide a frame of reference for how comparable companies in our size range set compensation opportunities as well as compensation trends;
- the nature and scope of the individual s role at Woodward compared to the benchmark job;
- the individual s performance, knowledge, skills, abilities, potential, and significant contributions to the Company and impact to shareholder value; and
- the cumulative impact of our retention efforts over the course of the individual s career.

In making compensation decisions and determinations, the Compensation Committee, in consultation with Aon and management, matches the NEOs with similarly positioned executives at companies in the peer comparator group, which we refer to as the benchmark position. These matches facilitate pay comparisons based on functional matches, job duties, responsibilities, level of impact, and organizational level.

When analyzing market data from our peer group, Aon presents data to the Compensation Committee at the 25th, 50th and 75th percentiles for reference points. However, we do not target any percentile or percentile range as a specific objective for the compensation we pay. Rather, our compensation decisions are based on the full consideration of all of the above mentioned elements that provide input into our deliberations and inform our decisions. As a result of evaluating compensation based on the criteria described above, total target compensation for our NEOs may in certain circumstances be above or below the reference points provided by Aon.

ELEMENTS OF COMPENSATION

Base Salary

Base salary is an important compensation component we must pay to remain competitive in our industry and the marketplace in general. The Compensation Committee generally sets base salary and annual adjustments at levels considered appropriate for comparable NEO positions at companies in our peer comparator group. Base salaries are reviewed by the Compensation Committee on an annual basis in the fourth quarter of the fiscal year preceding the effective date of the change. Specifically, base salaries are reviewed and approved in September of each year and are effective January 1st of the following year, which is a consistent practice for all employees of the Company as part of our Leading Performance Management Process.

Base salaries for the NEOs are assessed and set using a blend of quantitative and qualitative factors. Quantitative data in our peer comparator group is considered in determining our NEOs base salaries, and is presented to the Compensation Committee by Aon. We also consider qualitative performance data and factors to determine an NEO s base salary, including an individual NEO s performance, experience, responsibilities, management, leadership skills, and salary increase progression. For additional information, see the market data comparisons under the caption Compensation Decisions Compared to Market Data. Base salary is found in the Summary Compensation Table in the Salary column.

Annual Short-Term Incentive Compensation

Annual short-term incentive compensation is a key component of the total compensation package. The Omnibus Incentive Plan, which sets forth the material terms of any awards intended to qualify as performance-based compensation, permits the grant of annual cash-based incentive awards to eligible participants. These awards are provided pursuant to the WVIP under the authority provided in the Omnibus Incentive Plan. Management and non-management members participate in the WVIP to enhance organizational alignment, line of sight, and engagement toward the achievement of Company goals and objectives. The WVIP measures our internal annual financial and operational performance against pre-determined metrics. The WVIP is designed to provide short-term incentive compensation that is competitive with compensation offerings in our peer comparator group and to align compensation with financial performance drivers that are intended to benefit stockholders.

As with other components of variable compensation, quantitative data in our peer comparator group is considered in determining our NEOs annual short-term incentive compensation opportunity, and is presented to the Compensation Committee by Aon. We also consider other qualitative performance data and factors as described above. Based on these quantitative and qualitative factors, the Compensation Committee determined that the fiscal year 2018 annual incentive award opportunities for the NEOs would remain unchanged, as their annual incentive award opportunities were aligned with competitive levels. For additional information, see the market data comparisons under the caption Compensation Philosophy and Strategy Compensation Decisions Compared to Market Data.

In fiscal year 2015, Company management finalized the Company s strategic plan for the next five years, which the Company refers to as Woodward 150 , as 2020 will mark the 150th anniversary of the Company s establishment. Similar to prior years, to help ensure that the Company s short-term incentive plan was aligned with the key focus areas that support Woodward 150, Company management worked with Aon to assess the performance metrics comprising the WVIP, and where appropriate, to identify other potential performance metrics for consideration that would support Woodward 150. Based on the outcome of that assessment, management of the Company identified and recommended to the Compensation Committee for its consideration certain modifications to the design of the WVIP, including changes in certain performance metrics for fiscal year 2018. At the September and November 2017 meetings of the Compensation Committee, the Committee determined that it would be appropriate to make the proposed changes to the design of the fiscal year 2018 WVIP to further align it with remaining objectives and targets under Woodward 150. Specifically, the Compensation Committee replaced aftermarket revenue with working capital improvement as a performance metric to enhance focus on improved free cash flow, which is a critical metric of business performance.

The Compensation Committee believes that the modifications to the fiscal year 2018 WVIP will continue to drive the successful execution of Woodward 150, align pay and performance, enhance visibility for participants, and appropriately motivate performance in key areas of the business that are tied to stockholder value creation.

For fiscal year 2018, actual Company achievement of the overarching performance goal of net earnings determined each NEO s maximum possible WVIP incentive payout: up to a maximum WVIP payout of 1.0% of net earnings for the Chairman & CEO, 0.4% of net earnings for the CFO, and 0.33% of net earnings for the Presidents of ATS and ICS, and 0.3% for the GC. Setting maximum WVIP incentive payouts in this manner motivates achievement of net earnings, which strongly ties to stockholder value creation. The Compensation Committee had the discretion to reduce, but not increase, actual WVIP payouts from the maximum that became available based on the overarching performance goals.

At the time that the overarching and specific performance metrics were set, the Compensation Committee expected that each NEO s actual fiscal year 2018 WVIP payout would be lower than the maximum payment permitted upon achievement of the overarching performance goals. In particular, the specific performance metrics were intended to guide the Compensation Committee s use of negative discretion to determine WVIP payout amounts that were less than the maximum available based on the overarching performance goals.

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

For fiscal year 2018, the specific performance metrics are outlined in the table below and were designed using financial metrics as well as other performance metrics by business group.

PERFORMANCE MEASUREMENT	CEO, CFO, GC (%)	OTHER NEOS (%)
Woodward Adjusted Earnings Per Share	50	35
Woodward Adjusted EBITDA Margin(1)	25	-
Woodward Strategic Performance Measures(2)	25	-
Business Group Adjusted OEAB Margin(3)	-	35
Business Group Strategic Performance Measures(4)	-	30

(1) Adjusted EBITDA Margin means Adjusted EBITDA (as defined below) as a percentage of total Woodward sales.

(2) Strategic Performance Measures for our CEO, CFO and GC consist of overall Company (i) Working Capital Improvement (10% overall weighting) and (ii) Quality Improvement as measured through PPM percent decrease and Cost of Poor Quality decrease, weighted equally (a combined 15% overall weighting).

(3) Business Group Adjusted OEAB Margin means Adjusted OEAB (as defined below) as a percentage of the business group s total sales.

(4) Strategic Performance Measures for our other NEOs consist of the applicable business group s (i) Working Capital Improvement, and (ii) Quality Improvement as measured through PPM percent decrease and Cost of Poor Quality decrease. Each of the three foregoing Strategic Performance Metrics are weighted equally (10% each).

For fiscal year 2018, the Compensation Committee used a similar approach to establishing the threshold and maximum Adjusted EPS objective as that which was used in prior years. For fiscal 2018, the threshold Adjusted EPS performance goal was set at 90% of the target goal and the maximum performance goal was set at 110% of target. The Compensation Committee determined that this approach continues to incentivize stretch levels of performance, balances pay and performance, represents a reasonable range of financial performance, and is in line with peer group practices.

With respect to the approach used by the Compensation Committee to establish the threshold, target, and maximum performance goals for the other specific performance metrics, the Committee considered multiple factors that included, but were not limited to, historical performance, budgeted performance for fiscal 2018, and targeted levels of performance or improvement over multiple years. All of these metrics are established at a level that focuses on key business success factors that drive performance and challenge our management to achieve higher operational performance. Such targets are considered challenging, yet attainable, to achieve at the time they are set.

For purposes of WVIP metrics applicable to all employees, including NEOs, for fiscal year 2018, the Compensation Committee established performance targets based on adjusted earnings per share for 2018. Adjusted EPS , Adjusted EBITDA , and Adjusted OEAB mean the Company s reported diluted earnings per share, the Company s earnings before interest, taxes, depreciation, and amortization, and a Business Group s operating earnings after bonus, respectively, in each case calculated without consideration to unusual non-operational income, gains, expenses or losses totaling in excess of 3% of the Company s net earnings, the Company s EBITDA, or the Business Group s OEAB (as applicable) for the fiscal year, including but not limited to any such items that are related to or associated with any:

a) acquisitions or divestitures;

b) reorganization or restructuring activities;

c) litigation or claim judgments or settlements;

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

d) impact of any changes in or assumptions related to tax or other statutes, regulations or other applicable laws or accounting principles, and in each case, that were not previously contemplated;

e) foreign exchange fluctuations;

f) asset write-downs; or

g) other significant elements or items as provided in Section 11.2 of the Woodward 2017 Omnibus Incentive Plan.

Nonetheless, if at the end of the performance period, the Compensation Committee believes that the achievement of the specific performance metrics under the WVIP plan is not reflective of the Company s expected level of financial, operating or other performance, the Compensation Committee may in its discretion modify the amount of any WVIP payout to be made under the plan, but not above the maximum WVIP incentives available based on achievement of the overarching net earnings goal.

For fiscal year 2018, consideration of factors a) through f) above caused Adjusted EPS to be $0.57 higher than reported EPS. Specifically, upward adjustments were made for (i) expenses and earnings losses incurred in connection with M&A activities, (ii) restructuring and move-related charges, and (iii) an increase in the Company s share count as a result of the Company s decision to not resume share repurchases as previously intended; such upward adjustments were partially offset by net tax benefits associated with unplanned changes in tax laws. Similarly, upward adjustments with respect to Adjusted EBITDA for items (i) and (ii) above. Application of factors a) through f) above did not result in any other adjustments to the WVIP payouts. The following table reflects the metrics and performance with respect to Adjusted EPS, Adjusted EBITDA Margin, and Adjusted OEAB Margin components of the WVIP for our NEOs for 2018:

SPECIFIC PERFORMANCE METRIC	THRESHOLD	TARGET	MAXIMUM	ACTUAL FOR FY18
Woodward Adjusted Earnings Per Share($)(1)	3.06	3.40	3.74	3.39
Woodward Adjusted EBITDA Margin(%)(2)	17.5	18.0	19.0	17.6
ATS Adjusted OEAB Margin(%)(3)(5)	96.2	100	105.7	98.9
ICS Adjusted OEAB Margin(%)(4)(5)	84.3	100	107.9	66.1

(1) Plan metric for all NEOs.

(2) Plan metric for Messrs. Gendron, Weber and Fawzy.

(3) Plan metric for Mr. Patel, President, Aircraft Turbine Systems.

(4) Plan metric for Mr. Preiss, President, Industrial Control Systems.

(5) For competitive reasons, Woodward does not report OEAB Margin as part of its publicly disclosed financial statements. As a result, Woodward is disclosing OEAB Margin as a percent of target Adjusted OEAB Margin.

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

Adjusted EPS was $3.39, and the payout for the portion of the WVIP that pertains to the Adjusted EPS performance metric was 94.3% of target. Adjusted EBITDA Margin was equal to 17.6%, and the payout for the portion of the WVIP that pertains to the Adjusted EBITDA performance metrics was 40% of target. After giving effect to all WVIP performance metrics, the 2018 target and actual payout for each NEO under the WVIP are detailed in the following table:

NEO	TARGET AS A % OF BASE SALARY	ACTUAL PAYOUT AS % OF BASE SALARY	TARGET AMOUNT ($)	ACTUAL PAYOUT ($)
Thomas A. Gendron	100	70.3	925,000	650,275
Robert F. Weber, Jr.	75	52.7	389,711	273,967
A. Christopher Fawzy	65	45.7	274,337	192,859
Sagar A. Patel	65	48.3	312,150	231,927
Chad Preiss	65	39.6	287,250	174,935

Long-Term Incentive Compensation

The LTI Plan is a key component of the total compensation package. The Omnibus Incentive Plan authorizes the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, cash-based awards, and other stock-based awards.

We generally issue two forms of awards under the LTI Plan stock options and cash. We have determined that these two award forms are most appropriate for our NEOs due to their performance orientation and alignment with shareholder interests, as measured by stock price and financial performance, over the long-term. More specifically, we believe that stock options are aligned with shareholder interests because the awards do not convey value to recipients unless there is shareholder value creation after the date of grant. To balance long-term incentives based strictly on share price growth and to drive financial performance, we also grant cash awards under the Cash LTI Plan that are based on Woodward s 3-year financial performance. Specifically, the Cash LTI plan is based on two key financial metrics: Return on Capital and Net Earnings Per Share Growth, each of which is measured relative to companies of comparable size. In tandem, stock options and the Cash LTI Plan incent long-term financial performance that support the Company s stock price.

These awards are intended to offer competitive incentive opportunities to our executives and to align their interests with increasing shareholder value. The aggregate value of these awards equals the sum of the total delivered value of the stock options (as determined using the Black-Scholes methodology) plus the target cash award opportunity, and represents the total long-term incentive compensation for each NEO. As with short-term incentive compensation, quantitative data in our peer comparator group is considered in determining our NEOs long-term incentive compensation, and is presented to the Compensation Committee by Aon as discussed in Compensation Decisions Compared to Market Data above. We also consider other qualitative performance data and factors, including an individual NEO s performance, knowledge, skills, abilities, and significant contributions to the Company and shareholder value when establishing an award opportunity. Based on the considerations noted above, the Compensation Committee approved fiscal year 2018 long-term incentive award opportunities for the NEOs. For additional information, see the market data comparisons under the captions Compensation Philosophy and Strategy and Compensation Decisions Compared to Market Data.

At its regularly scheduled September meeting, the Compensation Committee approves a target delivered value for the stock option awards. The target value of each of the stock option awards is approved individually at this meeting. Typically one business day before the effective grant date of the award (such effective grant date being the first business day of the fiscal year), the Compensation Committee meets to establish the specific number of individual and aggregate awards based on the target delivered value and using a Black-Scholes value calculated using the closing price on NASDAQ of the Company s stock on the day prior to such approval meeting. The exercise price of the stock option awards is also determined on the effective grant date and is not less than (and is typically equal to) the closing price as quoted on The NASDAQ Global Select Market on that day. For fiscal year 2018, the Compensation Committee approved the grant of stock options on September 29, 2017 at an exercise price of $78.97, which was the closing price of Woodward common stock as quoted on NASDAQ on the effective grant date (October 2, 2017).

With respect to the Cash LTI, the Compensation Committee generally establishes a three-year performance period and compares the Company s performance to that of the companies comprising the S&P Mid Cap 400 Index. The Compensation Committee generally establishes the Cash LTI award metrics for a three-year performance cycle in the first quarter of the first fiscal year of the performance cycle preceding the first year of the performance cycle. For each NEO, the Compensation Committee also establishes a target Cash LTI, which is a percentage of the NEO s base salary at the beginning of the three-year performance cycle. The 2018-2020 performance period cycle was established in November 2017. The performance metrics for purposes of the Cash LTI for the multi-year cycles were determined by the Compensation Committee to be:

Return on Capital (50% weight)

Net Earnings per Share (EPS) growth (50% weight)

The performance metrics were selected because they are key measures to the success of the Company s business and aligned with shareholder value creation. Because the metrics are equally important to the Company, the performance metrics are weighted equally.

For the purposes of measuring relative performance, return on capital is defined as net income, adjusted for accounting changes and after-tax interest expense, divided by the sum of total debt, stockholder s equity, and any non-controlling interest. EPS for this purpose is measured as net income, adjusted for accounting changes, if any, divided by fully diluted common shares outstanding. EPS during the performance cycle is compared to a baseline EPS to calculate the growth in diluted EPS during such cycle. There are currently three relevant cycles: 2016-2018 (basis is reported EPS for fiscal year ended 2015 of $2.75), 2017-2019 (basis is reported EPS for fiscal year ended 2016 of $2.85), and 2018-2020 (basis is reported EPS for fiscal year ended 2017 of $3.16).

For purposes of developing the performance metrics for determining the payout under the Cash LTI, the Compensation Committee has approved a relative measure methodology that compares our performance to the companies in the S&P Mid Cap 400 Index, an external index. We believe that, for the Cash LTI, the S&P Mid Cap 400 Index relative measure methodology is an appropriate comparison of our performance against a larger and broader population of companies, which is representative of investment options available to the market. The Cash LTI performance metrics and corresponding payouts are based on our ranking within the S&P Mid Cap 400 Index for all performance cycles that are currently outstanding, and are as follows:

PERFORMANCE	PAYOUT
At 50^{th} percentile	50% of target
At 60^{th} percentile	100% of target
At 75^{th} percentile	200% of target

The above payout formula applies to each measure weighted equally. If performance is below the 50th percentile, no award will be earned or paid as it relates to that measure. Award amounts are interpolated for performance results between the above percentiles. Performance at the 60th percentile is necessary to earn a payout of 100% of target as it relates to that measure. We believe having a target payout at the 60th percentile sets a higher standard and is consistent with plan designs of other high performing companies in our peer group. The maximum award that can be earned for performance at or above the 75th percentile is 200% of target as it relates to that measure.

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

The reward targets established for each NEO are articulated as a percentage of base salary. These targets reflect the Compensation Committee s desire to establish a meaningful incentive linked to longer term financial performance of the Company that fits within our overall compensation philosophy and strategy.

For the 2016-2018 Cash LTI cycle, targets and actual payouts are detailed in the following table:

NEO	TARGET CASH LTI AWARD AS % OF 2016 BASE SALARY	ACTUAL AWARD AS % OF 2016 BASE SALARY	TARGET AMOUNT ($)	ACTUAL AWARD ($)
Thomas A. Gendron	50	54.5	445,000	485,049
Robert F. Weber, Jr.	40	43.6	194,200	211,677
A. Christopher Fawzy	25	27.3	99,000	107,910
Sagar A. Patel	35	38.1	156,205	170,262
Chad R. Preiss	35	38.2	140,000	152,601

Payouts for the 2016-2018 cycle were based on the following performance levels:

METRIC	COMPANY PERFORMANCE	ACTUAL PAYOUT AS A % OF TARGET
Return on Capital	54^{th} Percentile	68.0
Growth in Earnings per Share	68^{th} Percentile	150.0
Total		109.0

These performance levels resulted in awards that aggregate to 109.0% of target for each NEO for the 2016-2018 cycle. The amounts paid under the Cash LTI ending in fiscal year 2018 can be found above and in the Summary Compensation Table under Non-Equity Incentive Plan Compensation.

Other Compensation Programs

The NEOs are eligible to participate in the same health, welfare, and retirement benefits as all of our U.S. employee membership. These benefits include a group health insurance program; life insurance, inclusive of employee life, additional buy-up employee life, optional spouse life, and optional child life; Accidental Death & Dismemberment insurance; Short-Term Disability; Long-Term Disability; Woodward Retirement Savings Plan, inclusive of employee contributions and Company contributions (100% match on the first 3% of employee contributions, 50% on the next

3% of employee contributions, maxing at 4.5%); Woodward Stock Plan (Company contribution of 5% of eligible wages); and Retirement Income Plan (Company contribution of 1.5% of eligible wages, and 0.1% for each year of additional service). The Retirement Income Plan was closed to new participants as of September 30, 2003, with prior participants grandfathered.

Our NEOs are also eligible to participate in a deferred compensation plan, the Executive Benefit Plan (the EBP). The EBP is also available to other key members of management and to members of the Board. Employee participants are able to defer up to 50% of base salary, and up to 100% of any incentive (WVIP and/or Cash LTI) payments.

All plans are subject to applicable limitations set by the Internal Revenue Service (IRS). Supplemental contributions to the EBP (as more fully described below) are made for the Retirement Savings Plan, the Woodward Stock Plan, and the grandfathered Retirement Income Plan and are solely to restore for IRS limitations.

The benefits described in this section are paid to remain competitive in the marketplace. Amounts relating to certain of these benefits may be found in the All Other Compensation column of the Summary Compensation Table.

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COMPENSATION DISCUSSION AND ANALYSIS (continued)

Post-Employment Compensation and Employment Contracts

The Company s NEOs are not employed under general employment contracts and are employees at will.

We have entered into change in control agreements with each of the NEOs in order to help align actions and behaviors with, and in the best interests of, our stockholders in the event of a change of control transaction, to retain these executives through a change of control transaction and to enable them to remain focused on running the business to ensure a smooth transition. The change in control benefits are designed to preserve productivity, avoid disruption, and prevent attrition in the event we are involved in a change in control transaction.

Severance benefits are intended to ease the consequences of an unexpected termination of employment. These benefits are also designed to prevent our senior executives from seeking employment with our competitors after termination or soliciting our employees or customers during a period after termination of employment. The change in control severance program also motivates executives to pursue transactions that are in our stockholders best interests notwithstanding the potential negative impact of the transaction on their future employment. While cognizant of their terms, the Compensation Committee does not view the change in control agreements as an element of current compensation, and such arrangements do not necessarily affect the Compensation Committee s annual compensation decisions.

For a further description of the change in control agreements, see the information under the caption Executive Compensation Potential Payments Upon Termination or Change in Control Change in Control and Restrictive Covenant Agreements Post-Employment Provisions.

Impact of Accounting and Tax Issues on Executive Compensation

In setting each individual executive s compensation levels, we do not explicitly consider accounting and tax issues. We do, however, analyze the overall expense arising from aggregate executive compensation levels and awards and the components of our pay programs.

As one of the factors in our evaluation of compensation matters, we have considered the anticipated tax treatment to the Company and to the executive officers of various payments and benefits. Through the end of our fiscal year 2018, Section 162(m) of the Code placed a limit of $1,000,000 on the amount of compensation that we may deduct in any one year with respect to our CEO and each of the next three most highly compensated executive officers other than the CFO. Certain performance-based compensation approved by stockholders was not subject to this limit in accordance with the qualified performance-based compensation exemption under Section 162(m) of the Code. The Omnibus Incentive Plan permits the payment of compensation, including stock options and cash-based performance awards, that is intended to qualify as performance-based under Section 162(m). However, to maintain flexibility in compensating our key executives, it is not a stated requirement under the Omnibus Incentive Plan that all compensation must be deductible. The Company and the Compensation Committee has and will continue to consider various approaches regarding the deductibility of compensation payments (including paying compensation that is not fully tax deductible) to the extent reasonably practicable and to the extent consistent with our other compensation goals. However, the enactment of the Tax Cuts and Jobs Act of 2017 (the TCJA) effective for the first tax year commencing after December 31, 2017, which will apply to the Company beginning with the 2019 fiscal year, repealed the qualified performance-based compensation exemption and also expands somewhat the number of executive officers subject to the $1,000,000 limit.

Stock Ownership Guidelines

The Board has established stock ownership guidelines for non-employee directors and executives to align their interests and objectives with those of our stockholders. Non-employee directors are committed to minimum ownership of our common stock of a value equal to 5 times the annual base retainer paid at the date of election to the Board. The Chief Executive Officer is committed to minimum ownership value in an amount equal to 5 times his annual base salary, the Chief Financial Officer and Group Presidents are committed to a minimum ownership value equal to 3 times their respective annual base salaries, and Corporate Vice Presidents are committed to a minimum ownership value equal to 2 times their respective annual base salaries. Accumulation of the amount of stock required under the ownership guidelines is expected within 60 months of the date of such person s appointment or election. Shares held as owner of record or in brokerage account in the Woodward Retirement Savings Plan and unfunded deferred amounts denominated in Woodward Stock, all qualify towards the ownership guidelines. Unexercised and vested in-the-money stock options will also qualify towards up to a maximum of 50% of the ownership requirements. The Compensation Committee may in its discretion relieve any person of such obligations on a case-by-case basis, taking into consideration special circumstances such as retirement or health of the individual. As of the date of this proxy statement filing, all directors and officers were in compliance with the ownership guidelines.

Hedging and Pledging

Under our written policies, no directors or employees of the Company are permitted to purchase our stock on margin, or to short sell, buy or sell puts or calls, or to engage in any other transaction related to Woodward securities that is designed to hedge or offset any decrease in the market value of Woodward securities. In addition, directors and employees of the Company are not permitted to pledge Woodward stock under any circumstances.

Clawback Policy

In 2016, the Compensation Committee approved a Clawback Policy, which the Board believes exceeds or meets the forthcoming requirements pursuant to the Dodd-Frank Act. The Clawback Policy provides for the recovery by the Company, from any current or former executive officer who was employed by the Company during the three-year look back period (Covered Person), of any incentive-based compensation that was determined, in whole or in part, on the achievement of any financial or operating result of the Company, that was awarded erroneously to the Covered Person due to material noncompliance with any financial reporting requirement under the securities laws. A copy of the Clawback Policy is available at http://www.woodward.com/ClawbackPolicy.

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COMPENSATION COMMITTEE REPORT

Notwithstanding anything to the contrary set forth in any of the Company s previous or future filings under the Securities Act of 1933, or the Exchange Act, that might incorporate this Proxy Statement, in whole or in part, the following Woodward, Inc. Compensation Committee Report on Compensation Discussion and Analysis shall not be deemed to be soliciting material or filed with the SEC or incorporated by reference into any such previous or future filings.

The Compensation Committee is charged with certain responsibilities relating to compensation of the Company s executive officers. The Compensation Committee evaluates and approves all compensation of executive officers, including base salaries, short-term and long-term incentive compensation, and any perquisite programs of the Company. Compensation Committee determinations are presented to the Board.

The Compensation Committee also fulfills its duties with respect to the Compensation Discussion and Analysis and Compensation Committee Report portions of the proxy statement, as described in the Compensation Committee s charter.

The Compensation Discussion and Analysis was prepared by management of the Company. The Company is responsible for the Compensation Discussion and Analysis and for the disclosure controls relating to executive compensation. The Compensation Discussion and Analysis is not a report or disclosure of the Compensation Committee.

The Compensation Committee met with management of the Company and the Compensation Committee s outside consultant to review and discuss the Compensation Discussion and Analysis.

The Compensation Committee of the Board of Directors of the Company has reviewed and discussed the Compensation Discussion and Analysis included in this proxy statement and the 2018 Annual Report on Form 10-K with the management of the Company. Based on such review and discussions, the Compensation Committee recommended to the Board that the Compensation Discussion and Analysis be included in this proxy statement and the Company s 2018 Annual Report on Form 10-K, and the Board approved that recommendation.

Compensation Committee:	Mary L. Petrovich, Chairperson
	John D. Cohn
	Paul Donovan

James R. Rulseh

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EXECUTIVE COMPENSATION

Summary Compensation Table

The following tables set forth compensation information for the NEOs for services rendered in all capacities to the Company and its subsidiaries in fiscal year 2018.

NAME AND PRINCIPAL POSITION	FISCAL YEAR	SALARY ($)(1)	OPTION AWARDS (2)($)	NON-EQUITY INCENTIVE PLAN COMPENSATION (3)($)	ALL OTHER COMPENSATION (4)(5)($)	TOTAL ($)
Thomas A. Gendron	2018	925,000	3,930,177	1,135,324	111,063	6,101,564
	2017	915,577	4,453,715	1,815,700	107,025	7,292,017
Chairman, Chief Executive Officer and President	2016	924,231	3,212,712	1,599,030	106,339	5,842,312
Robert F. Weber, Jr.	2018	519,615	821,833	485,644	48,129	1,875,221
	2017	499,750	926,628	777,137	44,945	2,248,460
Vice Chairman, Chief Financial Officer and Treasurer	2016	499,712	666,066	684,815	43,544	1,894,137
A. Christopher Fawzy	2018	422,058	542,006	300,769	39,124	1,303,957
	2017	406,231	607,101	473,714	37,751	1,524,797
Corporate Vice President, General Counsel, Corporate Secretary and Chief Compliance Officer	2016	403,384	437,436	407,457	35,113	1,283,390
Sagar A. Patel	2018	480,231	567,216	402,189	44,788	1,494,424
	2017	463,619	624,307	621,240	42,542	1,771,708
President, Aircraft Turbine Systems	2016	456,604	459,903	632,920	40,193	1,589,620
Chad R. Preiss(6)	2018	441,923	524,360	327,536	51,790	1,345,609
President, Industrial Control Systems						

Note: The Stock Awards, Change in Pension Value and Non-Qualified Deferred Compensation Earnings columns have been omitted from this table because they are not applicable.

(1) Fiscal year 2016 reflected one additional pay period.

(2) Assumptions used in calculating the amounts in the Summary Compensation Table above are included in Note 19 of Woodward s financial statements in its Annual Report on Form 10-K for the fiscal year ended September 30, 2018, filed with the SEC on November 9, 2018.

(3) Amounts include compensation earned under our WVIP and our Cash LTI. See Compensation Discussion and Analysis for further information about the plans and how payouts were determined.

(4) The amounts reported include the following:

Woodward s contributions to the Retirement Savings Plan, which consists of a 401(k) component, a Woodward common stock component, and a Retirement Income Plan component (which was closed to new entrants hired after 2003).

Credit to the EBP for contributions to which the executive would have been entitled if the benefit had been calculated without regard to the limit under the Internal Revenue Code on total contributions, benefit eligible compensation, and/or salary deferrals.

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EXECUTIVE COMPENSATION (continued)

Table to footnote (4) above:

NAME	RETIREMENT SAVINGS PLAN ($)	EXECUTIVE BENEFIT PLAN CREDIT ($)	TOTAL ($)
Thomas A. Gendron	32,625	78,438	111,063
Robert F. Weber, Jr.	25,875	22,254	48,129
A. Christopher Fawzy	25,875	13,249	39,124
Sagar A. Patel	25,875	18,913	44,788
Chad R. Preiss	33,435	18,355	51,790

(5) Amounts do not include contributions by Woodward toward an executive physical program, as such amounts (inclusive of any other perquisites) are less than $10,000 in aggregate for each NEO.

(6) Mr. Preiss was not a NEO in 2016 or 2017.

Grants of Plan-Based Awards for Fiscal Year 2018 ending September 30, 2018

The following table provides additional information with respect to stock-based awards granted in fiscal year 2018, the value of which was provided in the Option Awards column of the Summary Compensation Table, and the potential range of payouts associated with the WVIP and Cash LTI for fiscal year 2018:

NAME	GRANT DATE	GRANT APPROVAL DATE		ESTIMATED POSSIBLE PAYOUTS UNDER NON-EQUITY INCENTIVE PLAN THRESHOLD ($)(1)	TARGET ($)	MAXIMUM ($)	ALL OTHER OPTION AWARDS: NUMBER OF SECURITIES UNDERLYING OPTIONS (SHARES)	EXERCISE OR BASE PRICE OF OPTION AWARDS ($/SHARE)	GRANT DATE FAIR VALUE OF STOCK AND OPTION AWARDS ($)(3)
			Cash LTI	231,250	462,500	925,000			

Thomas A. Gendron	10/02/2017	9/29/2017	WVIP(2)	0	925,000	1,850,000	155,900	78.97	3,930,177
			Cash LTI	105,000	210,000	420,000			
Robert F. Weber, Jr.	10/02/2017	9/29/2017	WVIP(2)	0	389,711	779,423	32,600	78.97	821,833
			Cash LTI	53,313	106,625	213,250			
A. Christopher Fawzy	10/02/2017	9/29/2017	WVIP(2)	0	274,337	548,675	21,500	78.97	542,006
			Cash LTI	84,700	169,400	338,800			
Sagar A. Patel	10/02/2017	9/29/2017	WVIP(2)	0	312,150	624,300	22,500	78.97	567,216
			Cash LTI	78,750	157,500	315,000			
Chad R. Preiss	10/02/2017	9/29/2017	WVIP(2)	0	287,250	574,500	20,800	78.97	524,360

(1) Threshold for this purpose means the minimum amount payable for threshold performance under the Cash LTI and the WVIP.

(2) The WVIP payment amounts are earned based on the achievement of the established financial performance objectives of the Plan on a sliding scale of 0% to 200% of the target amount established. These amounts are based on the individual s position and a percentage of the individual s base salary for the fiscal year preceding the year for which the WVIP incentive is payable. See Compensation Discussion and Analysis and Narrative Disclosure to Summary Compensation Table and Grants of Plan Based Awards Table for information regarding the description of performance-based conditions.

(3) The amounts reported in this column represent the grant date fair value of the option awards in accordance with ASC 718. Assumptions used in calculating these amounts are included in Note 19 of Woodward s financial statements in its Annual Report on Form 10-K for the fiscal year ended September 30, 2018 filed with the SEC on November 9, 2018.

Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards Table

Stock option awards consist of non-qualified options issued for a 10-year term. Each option tranche granted to eligible recipients, including NEOs, vests over four years at the rate of 25% per year. The exercise price represents the Woodward

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closing price as reported on NASDAQ on the effective date of the award. If employment is terminated (other than for reasons as described below), the options granted will be cancelled unless exercised within three months following the date of termination or the term of the option whichever is earlier. For stock options granted prior to October 1, 2013, if the termination is due to retirement, all outstanding options vest and must be exercised within three years from the date of retirement or the term of the option, whichever is earlier. For stock option awards granted on or after October 1, 2013, upon a termination of employment due to retirement, options will not accelerate and will continue to vest and be exercisable in accordance with the schedule established at the grant date. For the foregoing purposes, our directors are eligible for retirement upon attaining age 55, and the NEOs are eligible for retirement upon attaining age 55 with at least ten years of service with us or age 65 with no minimum years of service. Dividend equivalents are not paid on unexercised stock option awards.

The WVIP and the Cash LTI are presented in the Non-Equity Incentive Plan Compensation column of the Summary Compensation Table because each is a cash-based performance award. The actual amounts of the awards under the WVIP and the Cash LTI listed in the Non-Equity Incentive Plan Compensation column were paid in November 2018. The awards under both plans as set forth in the Grants of Plan-Based Awards Table are based on Threshold/Target/Maximum percentages applied to base wages as of the beginning of the fiscal year. If employment is terminated, the employee must have had full-time employee status at the end of the fiscal year, in the case of the WVIP, or at the end of the last fiscal year of the multi-year period, in the case of the Cash LTI, to receive a payout under both plans. If the termination is due to retirement, the payouts under both plans will be prorated. In either event, the payouts under both plans will be based on actual goal performance. Please see Compensation Discussion and Analysis for additional information relating to these provisions, including performance criteria relating to these plans.

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EXECUTIVE COMPENSATION (continued)

Outstanding Equity Awards at Fiscal Year End (September 30, 2018)

The following table provides information regarding the outstanding equity awards held by each of the NEOs as of September 30, 2018:

	OPTION AWARDS (1)			
NAME	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS EXERCISABLE	NUMBER OF SECURITIES UNDERLYING UNEXERCISED OPTIONS UNEXERCISABLE	OPTION EXERCISE PRICE ($)	OPTION EXPIRATION DATE
Thomas A. Gendron	125,000		23.18	10/01/2019
	155,000		32.04	10/01/2020
	160,000		25.57	10/03/2021
	142,800		33.64	10/01/2022
	157,700		40.99	10/01/2023
	135,600	45,200	46.55	10/01/2024
	121,550	121,550	40.26	10/01/2025
	45,300	135,900	62.57	10/03/2026
		155,900	78.97	10/02/2027
Robert F. Weber, Jr.	10,000		23.18	10/01/2019
	35,000		32.04	10/01/2020
	32,500		25.57	10/03/2021
	30,800		33.64	10/01/2022
	30,300		40.99	10/01/2023
	27,225	9,075	46.55	10/01/2024
	25,200	25,200	40.26	10/01/2025
	9,425	28,275	62.57	10/03/2026
		32,600	78.97	10/02/2027
A. Christopher Fawzy	6,000		23.18	10/01/2019
	16,500		32.04	10/01/2020
	18,300		25.57	10/03/2021
	19,000		33.64	10/01/2022
	21,100		40.99	10/01/2023

	17,625	5,875	46.55	10/01/2024
	16,550	16,550	40.26	10/01/2025
	6,175	18,525	62.57	10/03/2026
		21,500	78.97	10/02/2027
Sagar A. Patel	25,000		33.12	06/27/2021
	24,500		25.57	10/03/2021
	23,500		33.64	10/01/2022
	22,500		40.99	10/01/2023
	19,575	6,525	46.55	10/01/2024
	17,400	17,400	40.26	10/01/2025
	6,350	19,050	62.57	10/03/2026
		22,500	78.97	10/02/2027
Chad R. Preiss	28,000		23.18	10/01/2019
	25,000		32.04	10/01/2020
	23,000		25.57	10/03/2021
	21,600		33.64	10/01/2022
	20,900		40.99	10/01/2023
	17,475	5,825	46.55	10/01/2024
	15,300	15,300	40.26	10/01/2025
	5,750	17,250	62.57	10/03/2026
		20,800	78.97	10/02/2027

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EXECUTIVE COMPENSATION (continued)

(1) Option tranches granted to all employees and directors vest over four years at a rate of 25% per year.

Option Exercises and Stock Vested Table

The following table provides the amounts received (net of the exercise price) upon the exercise of options or similar instruments or the vesting of stock or similar instruments during fiscal year 2018:

	OPTION AWARDS	
NAME	NUMBER OF SHARES ACQUIRED ON EXERCISE	VALUE REALIZED ON EXERCISE ($)
Thomas A. Gendron	62,000	3,382,052
Robert F. Weber, Jr.	27,000	1,507,350
A. Christopher Fawzy	6,000	344,234
Sagar A. Patel	0	0
Chad R. Preiss	14,000	836,709

Nonqualified Deferred Compensation Table at Fiscal Year End (September 30, 2018)

The following table discloses contributions, earnings and balances under the EBP, the Company s nonqualified deferred compensation plan, for each NEO, during fiscal year 2018:

NAME	EXECUTIVE CONTRIBUTIONS ($)(1)	COMPANY CONTRIBUTIONS ($)(2)	AGGREGATE EARNINGS ($)	AGGREGATE WITHDRAWALS/ DISTRIBUTIONS ($)	AGGREGATE BALANCE AT SEPTEMBER 30 ($)(3)
Thomas A. Gendron	710,887	78,438	440,632	0	9,539,816
Robert F. Weber, Jr.	254,746	22,254	205,515	0	3,511,100
A. Christopher Fawzy	0	13,249	24,745	0	513,688

Sagar A. Patel	0	18,913	38,944	0	838,924
Chad R. Preiss	0	18,355	75,920	13,604	1,653,719

(1) These amounts are included in amounts reported in the Salary column of the Summary Compensation Table.

(2) These amounts are included in amounts reported in the All Other Compensation column of the Summary Compensation Table.

(3) The portion of the amounts shown in this column that were previously reported in the Summary Compensation Table is as follows: Mr. Gendron, $686,023; Mr. Weber, $447,057; Mr. Fawzy, $22,289; Mr. Patel, $55,493.

Narrative Disclosure of Nonqualified Deferred Compensation Table

The EBP is a non-qualified, deferred compensation plan that is designed to allow for supplemental retirement savings above the limits imposed by the IRS. If deferrals are above the Code limits on eligible compensation, then the account is credited by the Company with a percentage match contribution equivalent to that available under our Woodward Retirement Savings Plan. All contributions are made on a tax-deferred basis. Eligible participants are selected to participate based on criteria that includes incentive level, salary level and significant accountability to produce or contribute to key business results. Amounts deferred into the EBP are indexed to the same investment alternatives available to all eligible participants under the Retirement Savings Plan. Investment into Woodward common stock is generally permitted, except that supplemental contributions by the Company to the EBP are not permitted to initially be deemed invested in Woodward stock. Eligible employee participants may defer up to 50% of base salary for a plan year and up to 100% of cash incentive compensation. All elections must be made in advance of the plan year. At the time of the deferral election, the

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EXECUTIVE COMPENSATION (continued)

participant must designate the time and form of distribution. Distributions may be elected upon retirement or termination of employment. Distributions may also be elected for future dates during employment; however, any future date selected must be at least five plan years after the plan year in which the deferral is credited to the account. Distributions may be modified if executed a year before the originally scheduled distribution date. Distributions from the plan are made in cash; however, any payment made that is attributable to the portion of the participant s account deemed invested in Company stock is made in whole shares of Company stock with fractional shares paid in cash. Amounts included in the EBP are 100% vested at all times.

Potential Payments Upon Termination or Change in Control

This section explains the payments and benefits to which the NEOs would be entitled in various termination of employment scenarios. These are hypothetical situations only, as we currently employ all of the NEOs. For purposes of this explanation and these scenarios, we have assumed that termination of employment and change-in-control occurred on September 28, 2018, the last business day of our 2018 fiscal year.

The intent of this section is to isolate those payments and benefits for which the amount, vesting, or time of payment is altered by the termination of employment in the described circumstances. This section does not cover all amounts the NEOs would receive following termination. Specifically they are entitled to COBRA, life insurance conversion, and payouts from their Retirement Savings Plan; however, all employees are entitled to these benefits. In addition, the NEOs would receive the amounts earned under the short-term incentive plan and long-term incentive plan for the performance periods ending on September 30, 2018 (see Summary Compensation Table, non-equity incentive column).

Retirement

The age and years of service of the NEOs as of September 30, 2018 were as follows:

NAME	AGE	YEARS OF SERVICE
Thomas A. Gendron	57	28
Robert F. Weber, Jr.	64	13
A. Christopher Fawzy	49	11
Sagar A. Patel	52	7
Chad R. Preiss	53	30

Messrs. Gendron and Weber are retirement eligible and would receive the following upon retirement:

- A pro rata payout (based on service prior to retirement) at the conclusion of each open Cash LTI cycle based on actual company performance; and

- Continued vesting and exercisability (in accordance with the original vesting schedule) of unvested non-qualified stock options following retirement.

The following table shows the amount each NEO would receive on account of a retirement on the last business day of our fiscal year. Amounts shown for Non-qualified Stock Options reflect the value (calculated as of such date) of unexercisable options as reflected in the Outstanding Equity Awards at Fiscal Year End table above.

RETIREMENT(1)(2)	MR. GENDRON	MR. WEBER	MR. FAWZY	MR. PATEL	MR. PREISS
Cash LTI Award ($)(3)	462,500	204,667	0	0	0
Non-Qualified Stock Option ($)(4)	9,266,004	1,913,247	0	0	0

(1) If the NEO is involuntarily terminated for deliberate and serious disloyal or dishonest conduct, he would not be eligible for the benefits described above and his stock options would be cancelled.

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EXECUTIVE COMPENSATION (continued)

(2) Messrs. Fawzy, Patel and Preiss are not retirement eligible.

(3) Open LTI cycles include 2017-2019 and 2018-2020.

(4) Messrs. Gendron and Weber are retirement eligible; however, in the event of retirement, they would not receive accelerated vesting of any unvested stock option awards and hence no incremental associated benefit upon retirement. Rather, the unvested stock option awards reflected in this table would continue to vest in accordance with their original vesting schedule, and represent the unexercisable portion of the option awards as reflected in the Outstanding Equity Awards at Fiscal Year End table above.

Death

If a NEO dies while employed, the post-termination benefit consists of (for this purpose the date of death is assumed to be the last day of fiscal year 2018):

Incentive payouts from the Cash LTI compensation program to beneficiaries; and

Acceleration of vesting of non-qualified stock option awards (the value in this column represents the shares that vested due to this provision, with a market price as of the last day of fiscal year 2018).

NEOs who are retirement eligible receive, upon retirement, continued vesting (in accordance with the original vesting schedule) of any then-unvested options. Accordingly, death of an NEO would not result in vesting of any stock options that otherwise would have been forfeited for such retirement-eligible NEOs, although it would result in immediate vesting of such options. See Outstanding Equity Awards at Fiscal Year End table above for information regarding unvested (Unexercisable) options. The following table shows the amount each NEO would receive on account of death occurring on the last business day of our fiscal year:

DEATH	MR. GENDRON	MR. WEBER	MR. FAWZY	MR. PATEL	MR. PREISS
Cash LTI Award ($)(1)	462,500	204,667	103,875	166,133	150,500
Non-Qualified Stock Option ($)(2)(3)	0	0	1,252,958	1,321,262	1,175,850

(1)

The estimated amounts included above for open Cash LTI cycles are based on the Company attaining target level of performance and include open LTI cycles 2017-2019 and 2018-2020.

(2) Reflects the market price on the last day of the year and (where applicable) the exercise price of the option.

(3) Messrs. Gendron and Weber are retirement eligible, and hence no incremental stock option vesting would result from death of any such NEO, as described above.

Disability

If a NEO becomes totally and permanently disabled while employed (the date of disability is assumed to be the last day of the fiscal year), the post termination benefits consist of:

- A monthly payment under the Woodward, Inc. Long-Term Disability plan available to all employees;
- Incentive payouts from the Cash LTI compensation program; and
- Acceleration of vesting of non-qualified stock option awards (the value in this column represents the shares that vested due to this provision, with a market price as of the last day of fiscal year 2018).

NEOs who are retirement eligible receive, upon retirement, continued vesting (in accordance with the original vesting schedule) of any then-unvested options. Accordingly, termination of an NEO by reason of disability would not result in vesting of any stock options that otherwise would have been forfeited for such retirement-eligible NEOs, although it would result in immediate vesting of such options. See Outstanding Equity Awards at Fiscal Year End table above for information regarding unvested (Unexercisable) options. The following table

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EXECUTIVE COMPENSATION (continued)

shows the amount each NEO would receive on account of disability-related termination occurring on the last business day of our fiscal year:

DISABILITY	MR. GENDRON	MR. WEBER	MR. FAWZY	MR. PATEL	MR. PREISS
Cash LTI Award ($)(1)	462,500	204,667	103,875	166,133	150,500
Non-Qualified Stock Option ($)(2)(3)	0	0	1,252,958	1,321,262	1,175,850

(1) The estimated amounts included above for open Cash LTI cycles are based on the Company attaining target level of performance and include open LTI cycles 2017-2019 and 2018-2020.

(2) Reflects the market price on the last day of the year and (where applicable) the exercise price of the option.

(3) Messrs. Gendron and Weber are retirement eligible, and hence no incremental stock option vesting would result from a disability-related termination of any such NEO, as described above.

Change in Control and Restrictive Covenant Agreements Post-Employment Provisions

We have entered into transitional compensation agreements with certain of our officers, including all of our NEOs, which become operative only in the event of a qualifying termination following a Change of Control or other specified event.

For purposes of these agreements, a change in control occurs if:

- Any person, entity, or group (with certain exceptions) becomes the beneficial owner of 30% or more of the combined voting power of the then-outstanding shares of Woodward common stock;

- There is a change in a majority of the Board during any consecutive 12-month period, other than by election or nomination by a vote of two-thirds of the Board members as of the beginning of the period (such individuals or any such new directors, the Incumbent Board);

Woodward s stockholders approve a merger, consolidation, sale of assets, or share exchange, and in any such case, which is consummated and results in Woodward s stockholders owning less than 51% of the combined voting power of the surviving corporation following the transaction; or

During any consecutive 12 month period, Woodward sells or disposes of at least 40% of the total gross fair market value of the Company s assets in one or more transactions, unless after such transaction(s): (i) the Company s stockholders continue to hold 51% of voting power of the Company following the transaction, and (ii) at least a majority of the members of the Board following the transaction(s) were members of the Incumbent Board prior to the transaction(s).

If, following a change in control (but prior to the second anniversary of the occurrence thereof), the executive s employment is terminated by Woodward (other than for cause or due to death or disability), or the executive terminates with good reason (as defined in the agreement),

The executive would receive an amount (payable in a lump sum) equal to: (1) the executive s unpaid base salary, accrued vacation pay, unreimbursed business expenses, and any other accrued obligations owed by the Company to the executive; (2) a payment equal to the Company s cost to provide the executive with two years continued health and welfare benefit coverage under Company-provided plans; (3) a payment equal to two years of contributions the Company would have made on behalf of the executive to its tax-qualified defined contribution retirement plan(s); (4) a payment, pro-rated based on relevant service, of the greater of the then-current year s annual incentive award target or actual amount earned based on annualized year-to-date performance; (5) a payment, pro-rated based on relevant service, of the greater of target or the actual amount earned based on annualized year-to-date performance of all outstanding Cash LTI performance cycles; and (6) 100% (200% in the case of our CFO) of the sum of the executive s annual base salary and target annual incentive; and

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EXECUTIVE COMPENSATION (continued)

In consideration for the executive to enter into restrictive covenants in the event of a qualifying termination following a Change of Control covering: Noncompetition, Confidentiality, Nonsolicitation, Cooperation, and Nondisparagement, the executive would receive an incremental amount (payable in a lump sum) equal to 100% of the sum of the executive s annual base salary and target annual incentive.

In addition, all unvested stock option awards would be accelerated and become immediately exercisable.

The following table describes the payments and benefits that are triggered by the occurrence of a change in control and the termination of employment following a change in control. For purposes of this table, we have assumed the exercise of stock options on September 28, 2018, the last business day of fiscal year 2018, at the closing price on that day of $80.86 per share. NEOs who are retirement eligible receive, upon retirement, continued vesting (in accordance with the original vesting schedule) of any then-unvested options, even in the absence of a change in control. Accordingly, a change in control would not result in vesting of any stock options that otherwise would have been forfeited for such retirement-eligible NEOs, although it would result in immediate vesting of such options. See Outstanding Equity Awards at Fiscal Year End table above for information regarding unvested (Unexercisable) options.

CHANGE IN CONTROL	MR. GENDRON	MR. WEBER	MR. FAWZY	MR. PATEL	MR. PREISS
200% of Base Salary($)(1)	1,850,000	1,575,000	853,000	968,000	900,000
200% of Annual Target Bonus($)(1)	1,850,000	1,169,134	548,675	624,300	574,500
Pro Rata Bonus($)	925,000	389,711	274,337	312,150	287,250
Stock Options($)(2)(3)	0	0	1,252,958	1,321,262	1,175,850
Cash LTI($)(4)	462,500	204,667	103,875	166,133	150,500
200% of Retirement Savings Plan and Executive Benefit Plan Registrant Contributions in Most Recent Plan Year($)	222,126	96,258	78,248	89,576	103,580
Benefits: Health, Life, Disability for Two Years($)(5)	26,918	26,918	26,918	26,918	26,918
Effect of Alternate Cap Provision	0	0	0	0	0
Total($)	5,336,544	3,461,688	3,138,011	3,508,339	3,218,598

(1) 300% for Mr. Weber.

(2) Reflects the market price on the last day of the year and (where applicable) the exercise price of the option.

(3) Messrs. Gendron and Weber are retirement eligible, and hence no incremental stock option vesting would result from a change in control, as described above.

(4) The Cash LTI amounts reflected in the above table do not include payments for the completed 3-year cycle ended fiscal year 2018, which were otherwise earned as of September 30, 2018.

(5) Mr. Weber would receive continued coverage for 24 months under Woodward s health insurance plan in lieu of receiving a cash payment.

If the payments described above would constitute an excess parachute payment within the meaning of Section 280G of the Code, the Company would not provide reimbursement to the executive for any excise taxes

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EXECUTIVE COMPENSATION (continued)

imposed. In some instances, the executive may be subject to a 20% excise tax on a portion of the severance and other benefits payable upon a change in control. In such cases, the company does not provide a tax gross-up. However, the amount payable to the executive may be reduced to eliminate the excise tax, but only if the net-of-tax result to the executive is better than paying the excise tax.

Pay Ratio Disclosure

Pursuant to Section 953(b) of the Dodd-Frank Act and SEC rules, we are required to disclose the ratio of our principal executive officer s annual total compensation to the annual total compensation of our median employee. During fiscal 2018, the principal executive officer of Woodward was the Chairman, Chief Executive Officer and President, Mr. Gendron. For 2018, Mr. Gendron s annual total compensation, as reported in the Summary Compensation Table on page 45 was $6,101,564, and our median employee s annual total compensation was $61,747, resulting in a pay ratio of approximately 98.8 to 1.

In accordance with SEC rules, we identified the median employee as of July 1, 2018 by (i) aggregating for each applicable employee for the 12 month period from July 1 , 2017 through June 30, 2018 (A) regular pay received, (B) overtime paid, (C) pay premiums or differentials received, (D) sick pay received, (E) on-call pay received, and (F) vacation pay received, and (ii) ranking this aggregate compensation measure for our employees from lowest to highest. This calculation was performed for all employees of Woodward excluding Mr. Gendron, except as disclosed below. No annualizations were performed for employees hired or who took unpaid leave during fiscal 2018.

For purposes of identifying the median employee, all individuals acquired through Woodward s acquisition of L Orange GmbH in June 2018, totaling approximately 1,100 employees, were excluded from the analysis as permitted by SEC rules. Additionally, and independent of our application of the merger exception as indicated in the prior sentence, individuals (with corresponding number of employees) who were employed in the United Kingdom (74), India (64), Japan (59), Brazil (33), The Netherlands (30), Korea (13), Australia (3), France (3), Italy (2), Saudi Arabia (2), and United Arab Emirates (2) were excluded from the employee population, for purposes of this disclosure, pursuant to the de minimis exemption as permitted by SEC rules. After taking into consideration the foregoing exceptions, on July 1, 2018, we had 5,940 U.S. employees and 1,561 non-U.S. employees. Ignoring application of the de minimis exemption (but still excluding all individuals acquired through the acquisition of L Orange GmbH), on the same date we had 5,940 U.S. employees and 1,846 non-U.S. employees.

The pay ratio reported above is a reasonable estimate calculated in a manner consistent with SEC rules based on our internal records and the methodology described above. The SEC rules for identifying the median compensated employee and calculating the pay ratio based on that employee s annual total compensation allow companies to adopt a variety of methodologies, to apply certain exclusions, and to make reasonable estimates and assumptions that reflect their employee populations and compensation practices. Therefore, the pay ratio reported by other companies may not be comparable to the pay ratio reported above, as other companies have different employee populations and compensation practices and may utilize different methodologies, exclusions, estimates, and assumptions in calculating their own pay ratios.

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EXECUTIVE COMPENSATION (continued)

Equity Compensation Plan Information

The below table describes the total number of stock options that were awarded under the expired 2006 Omnibus Incentive Plan (the 2006 Plan) and the Omnibus Incentive Plan, and remain outstanding, as well as the number of shares of Woodward securities remaining available for future grants as of September 30, 2018.

PLAN CATEGORTY	NUMBER OF SECURITIES TO BE ISSUED UPON EXERCISE OF OUTSTANDING OPTIONS, WARRANTS, AND RIGHTS	WEIGHTED AVERAGE EXERCISE PRICE OF OUTSTANDING OPTIONS, WARRANTS, AND RIGHTS($)	NUMBER OF SECURITIES REMAINING AVAILABLE FOR FUTURE ISSUANCE UNDER EQUITY COMPENSATION PLANS (EXCLUDING SECURITIES REFLECTED IN THE FIRST COLUMN)
Equity compensation plans approved by security holders	5,621,769	45.43	1,276,825
Equity compensation plans not approved by security holders	0	0	0
Total	5,621,769	45.43	1,276,825

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AUDIT COMMITTEE REPORT TO STOCKHOLDERS

Notwithstanding anything to the contrary set forth in any of the Company s previous or future filings under the Securities Act of 1933 or the Exchange Act that might incorporate this Proxy Statement in whole or in part, the information set forth above under Board Meetings and Committees Audit Committee, relating to the charter of the Audit Committee and the independence of the Audit Committee members, and the following report shall not be deemed to be soliciting material or filed with the SEC or incorporated by reference into any such previous or future filings.

Audit Committee Report

The Audit Committee oversees the Company s financial reporting process and compliance with the Sarbanes-Oxley Act on behalf of the Board. Management has the primary responsibility for the financial statements and the reporting process, including maintaining an effective system of internal control over the Company s financial reporting.

Based on the review and discussions referred to in this report, we recommended to the Board that the audited financial statements for the year ended September 30, 2018, be included in the Company s Annual Report on Form 10-K filed with the SEC for the year ended September 30, 2018. Our recommendation was based on our review and discussion of the audited financial statements with management, and our discussions with Deloitte & Touche LLP, the independent registered public accounting firm that audited the financial statements.

In addition, our recommendation was based on our discussion with Deloitte & Touche LLP of the matters required to be discussed under Auditing Standard No. 1301, as amended. We also discussed with Deloitte & Touche LLP their independence, received from them the written disclosures and the letter required by Public Company Accounting Oversight Board Ethics and Independence Rule 3526, and considered whether the provision of services other than audit services (the fees for which are disclosed in the table that follows) is compatible with maintaining their independence. We based our recommendation on the foregoing discussions, disclosures and considerations.

Audit Committee: Gregg C. Sengstack, Chairman
Eileen P. Drake

Daniel G. Korte

Ronald M. Sega

Jonathan W. Thayer

Audit Committee s Policy on Pre-Approval of Services Provided by Independent Registered Public Accounting Firm

The Audit Committee is responsible for appointing, setting compensation for, and overseeing the work of the independent registered public accounting firm. As a result, the Audit Committee has established a policy regarding pre-approval of all services provided by the independent registered public accounting firm. Under the established policy, all audit and tax services and related fees require the specific approval of the Audit Committee. For audit-related services and all other services, the Audit Committee has determined specific services and dollar thresholds under which such services would be considered pre-approved. To the extent that management requests services other than these pre-approved services, or beyond the dollar thresholds, the Audit Committee must specifically approve the services. In situations where approval of such services is required prior to the next regularly scheduled meeting of the Audit Committee, the Audit Committee has delegated authority to approve such services to the Chairman of the Audit Committee. Furthermore, under the established policy, the independent registered public accounting firm is prohibited from performing the non-audit services identified by the SEC and the Public Company Accounting Oversight Board (PCAOB) as prohibited. The policy also requires management to periodically prepare reports for the Audit Committee on the Company s use of the independent registered public accounting firm.

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AUDIT COMMITTEE REPORT TO STOCKHOLDERS (continued)

Fees Paid to Independent Registered Public Accounting Firm

The following table represents fees for professional audit services rendered by Deloitte & Touche LLP for the audit of the Company s consolidated financial statements as of and for the years ended September 30, 2018 and September 30, 2017 and fees billed for other services rendered by Deloitte & Touche LLP during that period. All of such fees were approved in accordance with the Pre-approval Policy described above.

YEAR ENDED SEPTEMBER 30	2018($)	2017($)
Audit Fees	2,664,090	2,572,105
Audit Related Fees(1)	896,008	10,015
Tax Fees	601,562	638,232
All Other Fees	28,257	3,790
Total	4,189,917	3,224,142

(1) Audit Related Fees consist of assurance and related services that are reasonably related to the performance of the audit of the financial statements. This category includes fees for pension and benefit plan audits, consultations concerning accounting and financial reporting standards, assistance with statutory financial reporting, consultation on general internal control matters or Sarbanes-Oxley Act assistance, due diligence related to mergers and acquisitions, and other auditing procedures and issuance of special purpose reports.

In November 2018, the Audit Committee recommended and approved the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm.

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PROPOSAL 2 RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Audit Committee has selected the accounting firm of Deloitte & Touche LLP to serve as the Company s independent registered public accounting firm for the fiscal year ending September 30, 2019. The decision of the Audit Committee to appoint Deloitte & Touche LLP was based on careful consideration of the firm s qualifications as an independent registered public accounting firm. Deloitte & Touche LLP was originally selected by the Audit Committee as the Company s independent registered public accounting firm effective December 6, 2007.

Although the Audit Committee is directly responsible for the appointment, compensation, retention and oversight of the work of any independent registered public accounting firm engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Company, the Audit Committee and the Board are requesting, as a matter of policy, that stockholders ratify the appointment of Deloitte & Touche LLP as the Company s independent registered public accounting firm for the fiscal year ending September 30, 2019. The Audit Committee is not required to take any action as a result of the outcome of the vote on this proposal. However, if the stockholders do not ratify the appointment, the Audit Committee would investigate the reasons for the stockholders rejection and would consider whether to retain Deloitte & Touche LLP or to appoint another independent registered public accounting firm. Furthermore, even if the appointment is ratified, the Audit Committee in its discretion may direct the appointment of a different independent registered public accounting firm at any time during the year if it determines that such a change would be in the best interests of the Company and its stockholders.

A proposal to ratify the appointment of Deloitte & Touche LLP for the current year will be presented at the Annual Meeting. A representative from Deloitte & Touche LLP is expected to attend the Annual Meeting and will have the opportunity to make a statement, if he or she desires to do so, and be available to answer appropriate questions.

Your Board unanimously recommends a vote FOR the ratification of the appointment of the independent registered public accounting firm presented in Proposal 2.

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PROPOSAL 3 ADVISORY RESOLUTION REGARDING THE COMPENSATION OF THE NAMED EXECUTIVE OFFICERS

As required by Section 14A of the Securities Exchange Act of 1934, we are offering our stockholders an opportunity to cast an advisory vote on the compensation of our named executive officers, as disclosed in this proxy statement. Additionally, and in response to the advisory vote of our stockholders at our 2016 Annual Meeting regarding the recommended frequency of such an advisory resolution, we have presented this proposal to stockholders on an annual basis. Although the vote is non-binding, we value continuing and constructive feedback from our stockholders on compensation and other important matters. The Board and the Compensation Committee will consider the voting results when making future compensation decisions.

As described in the Compensation Discussion and Analysis section of this proxy statement, we believe that our executive compensation program (1) provides a competitive total compensation program that enables us to attract, retain and motivate a high-performance executive management team, and (2) aligns the interests of the NEOs with the interests of our stockholders in different ways, by focusing on both short-term and long-term performance goals, by promoting ownership of the Company, and by linking individual performance to our fundamental financial performance. For example:

- We encourage long-term stock ownership by our executive officers with award features, such as graduated vesting on stock option award tranches at 25% per year beginning on the first anniversary of the grant date.

- Our annual incentive compensation plans are aligned between Company executives and all other employees of the Company to promote unified achievement of Company goals and objectives.

- We establish total compensation (base salary, annual short-term cash incentives, and long-term incentives) for each NEO that is competitive with total compensation for executives in comparable positions at companies in our peer comparator group.

- We place a strong emphasis on variable compensation, which is designed so that the payout opportunity is directly linked to the achievement of pre-determined financial performance metrics, with upside opportunity for exceeding the pre-determined goals.

- Our allocation of cash compared to non-cash compensation is weighted significantly toward cash-based compensation in order to (1) minimize the extent to which the interests of existing stockholders are diluted by equity used as compensation and (2) balance operating performance with delivering returns to our stockholders.

In light of our fiscal year 2018 financial results, we believe that the compensation paid to our NEOs in fiscal year 2018 was aligned with our financial performance for the reasons discussed under the caption Compensation Discussion and Analysis Compensation Philosophy and Strategy Fiscal Year 2018 Pay for Performance.

We have stock ownership guidelines that require our CEO to own shares of our common stock equal to 5 times annual base salary; our CFO and business group Presidents to own shares of our common stock equal to 3 times annual base salary; and our Corporate Vice Presidents to own shares of our common stock equal to 2 times annual base salary, other than in special circumstances as may be determined by the Compensation Committee.

We believe that proper administration of our executive compensation program should result in the development of a management team that improves our fundamental financial performance and provides value to the long-term interests of the Company and its stockholders. Additional information relevant to your vote can be found in the Compensation Discussion and Analysis and Executive Compensation sections of this proxy statement.

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PROPOSAL 3 ADVISORY RESOLUTION REGARDING THE COMPENSATION OF THE NAMED EXECUTIVE OFFICERS (continued)

For these reasons, we recommend that stockholders vote in favor of the following advisory resolution:

RESOLVED, that the compensation paid to Woodward s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including the Compensation Discussion and Analysis, compensation tables and narrative discussion presented in Woodward s proxy statement for its 2018 Annual Meeting of Stockholders, is hereby APPROVED.

Your Board unanimously recommends that you vote FOR this advisory resolution.

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN

At the 2016 Annual Meeting, stockholders of the Company approved the Woodward, Inc. 2017 Omnibus Incentive Plan, and at the 2017 Annual Meeting, the stockholders of the Company approved the Amended and Restated Woodward, Inc. 2017 Omnibus Incentive Plan (together, the Woodward Omnibus Incentive Plan or the Omnibus Incentive Plan). The Woodward Board of Directors (the Board) has adopted certain amendments to the Omnibus Incentive Plan, subject to stockholder approval. Stockholders are now being asked to approve such amendments, as described herein.

The Omnibus Incentive Plan is intended to attract and retain the best available individuals for positions of substantial responsibility, and to provide to such individuals additional incentives that are aligned with and promote the success of the Company. The Omnibus Incentive Plan also is intended to encourage stock ownership by employees, consultants, or non-employee directors who are granted awards under the Omnibus Incentive Plan (Participants), thereby further aligning their interests with those of the Company s stockholders.

The amendments to the Omnibus Incentive Plan that are being submitted for stockholder approval include:

- An increase in the number of shares reserved for issuance by 1,400,000;

- The addition of a fungible share provision, under which any award other than a stock option or stock appreciation right and which is settled in shares (a Full Value Award) that is made on or after the 2018 Annual Meeting will reduce the number of shares remaining under the share authorization under the Omnibus Incentive Plan by two shares for each share actually subject to any such Full Value Award. This provision is in replacement of the former provision in the Omnibus Incentive Plan that capped the total number of Full Value Awards that could be granted under the Omnibus Incentive Plan to 200,000 shares in the aggregate; and

- The specification that no dividends will be paid on shares that are covered by unexercised stock options or stock appreciation rights.

Other than as described above, no material changes to the Omnibus Incentive Plan are proposed.

Determination of Number of Shares to Add to the Omnibus Incentive Plan

In determining the number of additional shares to propose to make available under our Omnibus Incentive Plan, the Board considered the following factors:

- **Remaining Competitive**. The Omnibus Incentive Plan plays an important role in our effort to align the interests of Participants and stockholders. Moreover, in our industry, equity compensation awards are an important tool in recruiting, retaining and motivating highly qualified technical and other key employees, upon whose efforts our success is dependent.

Potential Dilution. The potential dilution from the additional 1,400,000 shares to be added to the Omnibus Incentive Plan is 2.27%, based on total shares outstanding as of September 30, 2018.

Past Usage of Shares. Over the past three fiscal years, the Company s average annual dilution from grants under the Omnibus Incentive Plan was 1.36%. Dilution for this purpose was calculated as the number of equity awards granted during the fiscal year, less cancellations, as a percentage of total outstanding shares as of the end of that fiscal year.

Future Use of Shares. In determining projected share usage, the Compensation Committee considered a forecast that included the following factors: (1) the 1,276,825 shares that remained available under the Omnibus Incentive Plan as of September 30, 2018; (2) the additional 1,400,000 shares that would be available for grant under the Omnibus Incentive Plan, if stockholders approve the amendments to the Omnibus Incentive Plan; (3) estimated cancellations that may return to the Omnibus Incentive Plan

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

in the future; and (4) forecasted future grants. After considering these factors, we currently anticipate that the shares under the Omnibus Incentive Plan will be sufficient for our purposes for approximately 1-2 years. However, future circumstances and changes in our business needs may result in the shares being exhausted earlier or later than this estimate.

Overhang. The Compensation Committee also considered overhang, which measures the number of shares subject to equity awards outstanding but unexercised, plus the number of shares available to be granted, as a percentage of total shares outstanding. As of September 30, 2018, we had 5,611,469 stock options that were awarded and remained outstanding, all of which were granted under the Omnibus Incentive Plan or our expired 2006 Omnibus Incentive Plan (the 2006 Plan). 4,109,650 of this total were outstanding under the 2006 Plan. We had no stock appreciation rights outstanding as of that date. The weighted-average remaining contractual term of the outstanding stock options as of September 30, was 5.6 years and the weighted-average exercise price per Share of those stock options was $45.42. Also, as of September 30, 2018, we had 10,300 Full Value Awards that were awarded and remained outstanding, all of which were granted under the Omnibus Incentive Plan. The foregoing, together with the 1,276,825 shares remaining available for future grant under the Omnibus Incentive Plan and the 1,400,000 shares to be added to the Omnibus Incentive Plan, would represent approximately 4.33% of our total outstanding common shares as of September 30, 2018. No shares remain available for grant under the 2006 Plan.

In developing the number of shares to add to the Omnibus Incentive Plan, the Board considered proxy advisory firm guidelines in order to increase the likelihood of a positive recommendation from those firms, as well projected future share usage needs for the Company to be able to make competitive grants to Participants.

Why Stockholders Should Approve the Amendments to the Omnibus Incentive Plan

Equity awards are an important component of the Company s compensation program. The Omnibus Incentive Plan, including the amendments described herein, will help the Company to continue to attract and retain the services of qualified employees, officers and non-employee directors (such directors, Outside Directors).

Equity incentives align the interests of our employees, officers and Outside Directors with those of other stockholders. Equity incentives appropriately incent recipients to focus on growth in stockholder value.

Shares Remaining Available under the Omnibus Incentive Plan may be Insufficient. The Shares that remain available under the Omnibus Incentive Plan may be insufficient for our future needs in attracting, retaining and motivating our employees, officers and Outside Directors.

Effect of Stockholder Approval of Amendments to the Omnibus Incentive Plan

If stockholders approve the amendments described herein to the Omnibus Incentive Plan, such new version will supersede the version of the Omnibus Incentive Plan that was approved by stockholders at our last Annual Meeting. If stockholders do not approve the additional amendments to the Omnibus Incentive Plan described herein, we will continue to use the version of the Omnibus Incentive Plan that was approved by stockholders at our last Annual Meeting, with the addition of the provisions that no dividends will be paid on shares that are covered by unexercised stock options or stock appreciation rights. However, absent the share increase proposed herein, the shares that remain available for issuance under the Omnibus Incentive Plan may not, in the future, be sufficient for us to be able to achieve our goals of attracting, motivating and retaining our employees through grants of equity awards.

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

Woodward Omnibus Incentive Plan Summary

The following is a summary of the principal features of the Omnibus Incentive Plan as proposed to be further amended. The summary is qualified in its entirety by reference to the Omnibus Incentive Plan, inclusive of the proposed additional amendments, which is attached to this proxy statement as Exhibit A. Any terms not capitalized but not defined herein shall take the meaning ascribed to them in the Omnibus Incentive Plan.

The Omnibus Incentive Plan permits the Company to grant various types of incentive awards, including: (1) stock options, (2) stock appreciation rights, (3) restricted stock, (4) performance units, (5) performance shares, (6) restricted stock units, (7) other stock-based awards, (8) annual incentive awards, and (9) cash-based awards (individually, an Award, and collectively, Awards). The Omnibus Incentive Plan limits the awards that an individual Participant may receive in any fiscal year of the Company (Fiscal Year). Specifically, a Participant may receive during any fiscal year: (i) no more than 600,000 Shares subject to stock options and stock appreciation rights (subject to an additional award of up to 900,000 Shares in the fiscal year of hire); (ii) no more than 150,000 Shares subject to Full Value Awards (subject to an additional award of an additional 50,000 Shares in the fiscal year of hire); and (iii) the maximum amount that may be paid for all performance periods ending during a Fiscal Year) with respect to cash-based Awards is $10,000,000. No Outside Director may be granted Awards which, in the aggregate, exceed $300,000 in grant date fair value (calculated under generally accepted accounting principles), provided that such amount is increased to $450,000 in the Fiscal Year of his or her initial service as an Outside Director. Any Awards or other compensation provided to an Outside Director for his or her services as a consultant or employee are excluded from these Outside Director Award limitations.

Shares Reserved

The Omnibus Incentive Plan authorizes the grant of Awards with respect to an aggregate of 4,200,000 shares of common stock of the Company, of which 1,400,000 are being added subject to stockholder approval. These 1,400,000 shares equal approximately 2.26 percent of the Company s outstanding shares as of November 26, 2018. Shares issued under the Omnibus Incentive Plan may either be (i) authorized but unissued shares or (ii) shares that have been or may be reacquired in the open market, in private transactions, or otherwise. As of November 26, 2018, the closing price of our common stock on NASDAQ was $82.01 per share.

The Omnibus Incentive Plan does not permit what is known as liberal share recycling. Upon exercise of a stock appreciation right settled in shares, the gross number of shares covered by the portion of the Award so exercised will cease to be available under the Omnibus Incentive Plan. Shares that have been actually issued under the Omnibus Incentive Plan pursuant to any Award will not be returned to the Omnibus Incentive Plan and will not become available for future grant or sale under the Omnibus Incentive Plan, except that if unvested shares of Full Value Awards are repurchased by the Company or are forfeited to the Company, those shares will become available for future grant or sale under the Omnibus Incentive Plan (unless the Omnibus Incentive Plan is terminated). Shares used to pay the exercise price or purchase price of an Award, acquired in open market transactions using option proceeds, and/or used to satisfy withholding taxes related to the Award will not be available for future grant or sale under the Omnibus Incentive Plan. For purposes of clarification, no shares purchased by the Company with proceeds received from the exercise of an option will become available for issuance under the Omnibus Incentive Plan.

If an option or stock appreciation right expires or becomes unexercisable without having been exercised in full, then the unexercised shares subject thereto will become available for future grant or sale under the Omnibus Incentive Plan. If a Full Value Award is forfeited or repurchased by the Company, then the forfeited or repurchased shares subject thereto will become available for future grant or sale under the Omnibus Incentive Plan. To the extent an Award is paid out in cash rather than shares, such cash payment will not result in reducing the number of shares available for issuance under the Omnibus Incentive Plan.

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

Furthermore, any Full Value Award that is granted on or after January 30, 2019 will reduce the number of shares remaining under the share authorization by two shares for each share actually subject to the Full Value Award. If any part of such a Full Value Award is forfeited, repurchased by the Company due to a failure to vest, paid out in cash, or returned to the Omnibus Incentive Plan for any other reason set forth in the Omnibus Incentive Plan, an equal amount (that is, twice the number of Full Value Awards being forfeited or cancelled) will be returned to the Omnibus Incentive Plan and will increase accordingly the number of shares remaining under the share authorization.

Administration

The Omnibus Incentive Plan is administered by the Compensation Committee or another committee as may be delegated in accordance with the Omnibus Incentive Plan or as described in the Delegation of Authority section above (the Committee). To the extent deemed desirable by the Board or the Committee, the Committee consists of at least two directors, both of whom qualify as non-employee directors under Rule 16b-3 of the Securities Exchange Act of 1934 and as outside directors under Code Section 162(m). Except to the extent prohibited by applicable laws, the Committee may delegate to one or more individuals the day-to-day administration of the Omnibus Incentive Plan and/or any of the functions assigned to the Committee in the Omnibus Incentive Plan. Any such delegation may be revoked by the Committee at any time.

Subject to the other provisions of the Omnibus Incentive Plan, and in the case of a Committee, subject to the specific duties delegated by the Board to such Committee, the Board or Committee (as applicable) will have the authority, in its discretion:

a) to select the employees, Outside Directors and consultants of the Company and its subsidiaries (Service Providers) to whom Awards may be granted;

b) to determine the number of shares or dollar amount to be covered by each Award;

c) to approve forms of Award Agreements for use under the Omnibus Incentive Plan;

d) to determine the terms and conditions, not inconsistent with the terms of the Omnibus Incentive Plan, of any Award based in each case on such factors as the Committee will determine, including, but not limited to, the exercise price of an Award, the time or times when Awards vest or may be exercised (which may be based on performance criteria), any vesting acceleration or waiver of forfeiture restrictions and any restriction or limitation regarding any Award or the shares relating thereto;

e) to construe and interpret the terms of the Omnibus Incentive Plan and each Award;

f) to prescribe, amend and rescind rules and regulations relating to the Omnibus Incentive Plan, including rules and regulations relating to sub-plans established for the purpose of satisfying applicable foreign laws or for qualifying for favorable tax treatment under applicable foreign laws;

g) to modify or amend each Award, including, but not limited to, the discretionary authority to accelerate the vesting of Awards (notwithstanding the one year minimum vesting schedule described below), to extend the post-termination exercisability period of Awards and to extend the maximum term of an option (but in no event longer than 10 years from the date of the Award);

h) to determine the manner in which Participants may satisfy any applicable tax obligations;

i) to authorize any person to execute on behalf of the Company any instrument required to effect the grant of an Award previously granted by the Committee;

j) to allow a Participant, in compliance with applicable laws including, but not limited to, Code Section 409A, to defer the receipt of the payment of cash or the issuance of shares that would otherwise be due to such Participant under an Award;

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

k) to impose such restrictions, conditions or limitations as the Committee determines appropriate as to the timing and manner of any resales by a Participant or other subsequent transfers by the Participant of any shares issued as a result of or under an Award, including without limitation, (i) restrictions under an insider trading policy, (ii) restrictions as to the use of a specified brokerage firm for such resales or other transfers, and (iii) requirements for holding shares in order to comply with share ownership policies or guidelines adopted by the Company from time to time; and

l) to require that the Participant s rights, payments and benefits with respect to an Award (including amounts received upon the settlement or exercise of an Award) will be subject to reduction, cancellation, forfeiture or recoupment upon the occurrence of certain specified events, in addition to any otherwise applicable vesting or performance criteria of an Award, as may be specified in an Award Agreement at the time of grant, or later if (i) applicable laws require the Company to adopt a policy requiring such reduction, cancellation, forfeiture or recoupment, or (ii) pursuant to an amendment of an outstanding Award; to make all other determinations the Committee deems necessary or advisable for administering the Omnibus Incentive Plan.

The Board has delegated to our Chief Executive Officer limited authority to make certain equity grants of non-qualified stock options, Restricted Stock Units and Restricted Stock Awards under the Omnibus Incentive Plan during the interval between regularly scheduled meetings of the Compensation Committee, which authority would continue under amendments described herein. The Chief Executive Officer is not authorized to (i) make interim equity grants to members of the Board or to elected officers of the Company, or (ii) make, to any individual, any interim equity grant that is greater than 15,000 nonqualified stock options or 5,000 shares of Restricted Stock Units or Restricted Stock Awards. The Board at any time may revoke the authority of the Chief Executive Officer to make interim grants.

Eligibility

Service Providers (including the persons named in the Summary Compensation Table below) will be eligible to be selected to receive Awards under the Omnibus Incentive Plan. The actual number of individuals who will receive Awards cannot be determined in advance because the Committee has the discretion to select the Participants. As of November 26, 2018, approximately 9,111 persons, including approximately 8,523 employees, 579 independent contractors, and 9 Outside Directors, were eligible to be selected to receive Awards under the Omnibus Incentive Plan. As of the same date, 178 persons, including 168 employees, 10 current and former Outside Directors, and 0 independent contractors had been granted Awards under the Omnibus Incentive Plan.

Duration

The amendments to the Omnibus Incentive Plan would be effective January 30, 2019, subject to an affirmative vote of a majority of the votes cast on this Proposal 4 at the Annual Meeting. No options intended to be incentive stock options may be granted under the Omnibus Incentive Plan after September 13, 2026, unless further stockholder approval (after the 2018 Annual Meeting) is obtained.

Adjustments

The Omnibus Incentive Plan provides for equitable adjustment by the Committee, in the event that any dividend or other distribution (whether in the form of cash, shares, other securities, or other property), recapitalization, stock split, reverse stock split, reorganization, reincorporation, reclassification, merger, consolidation, split-up, spin-off, combination, repurchase or exchange of shares or other securities of the Company, or other change in the corporate structure of the Company affecting the shares occurs. In the event of any such occurrence, the Committee, in order to prevent diminution or enlargement of the benefits or potential benefits intended to be made available under the Omnibus Incentive Plan, will adjust the number and class of shares of stock that may be issued under the Omnibus Incentive Plan, the number, class and price of

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

shares of stock covered by each outstanding Award, and/or the numerical share limits under the Omnibus Incentive Plan.

No Repricings

The Omnibus Incentive Plan expressly prohibits option repricing and certain other actions known as an Exchange Program. The Committee may not implement an Exchange Program (as defined) unless stockholders approve an amendment to the Omnibus Incentive Plan that permits the implementation of an Exchange Program. We are not requesting stockholders to approve any such amendment at this time.

No Dividends or Distributions on Unvested Awards

Any dividends or distributions on unvested shares subject to Full Value Awards granted under the Omnibus Incentive Plan will not be paid immediately to the Participant and instead will be subject to the same vesting schedule as the underlying shares on which the dividend or distribution is paid. In addition, no dividends or distributions will be paid on any unexercised shares covered by stock options or stock appreciation rights. Notwithstanding the preceding, adjustments may be made in unvested Awards as provided in Adjustments above.

Minimum Vesting Requirements

No Award (other than cash-based Awards) will be scheduled to vest earlier than the one-year anniversary of the grant date of such Award unless the Participant dies or becomes disabled. Notwithstanding the foregoing, (a) Awards that result in the issuance of an aggregate of up to five percent (5%) of the total shares available under the Omnibus Incentive Plan may be granted with vesting schedules that do not follow the minimum one year vesting rule, and (b) after a stock-based Award has been granted, the Committee has discretion to accelerate the vesting of an Award. In addition, as explained below under Change in Control, Awards will accelerate vesting if they are not assumed by a successor entity, notwithstanding the minimum one year vesting schedule. The minimum one year vesting schedule does not apply to the cash-based annual incentive, other cash-based Awards, stock options Awards, or stock appreciation rights granted under the Omnibus Incentive Plan prior to January 24, 2018.

Options

The exercise price of each option will be determined by the Committee and set forth in the Award Agreement; provided, however, that such exercise price may generally not be less than one hundred percent (100%) of the fair market value of a share on the effective grant date of the Award. The maximum term of each option will be ten (10) years from its effective grant date or such shorter term as may be provided by the Committee and set forth in the Award Agreement. The Committee will determine whether the options are intended to be incentive stock options (which may receive more favorable tax treatment to the Participant under the Code) or nonqualified stock options (which do not qualify as incentive stock options).

The Committee may provide for the acceptable form of consideration for exercising an option, including the method of payment. Such consideration may consist of:

a) cash;

b) check;

c) promissory note, to the extent permitted by applicable laws;

d) other shares, provided that such shares have a fair market value on the date of surrender equal to the aggregate exercise price for the shares with respect to which such option will be exercised and provided that accepting such shares will not result in any adverse accounting consequences to the Company, as the Committee determines in its sole discretion;

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PROPOSAL 4 APPROVAL OF AMENDMENTS TO THE WOODWARD OMNIBUS INCENTIVE PLAN (continued)

7.3

1.6

3.9

0.8

Total feedstocks

456.3

100.0

%

472.6

100.0

%

450.3

100.0

%

446.1

100.0

%

436.3

100.0

%

Production:

Light Products:

Conventional gasoline

174.6

37.9

%

193.0

40.4

%

184.8

39.9

%

182.5

39.7

%	
	186.5
	41.0
%	
Premium and reformulated gasoline	
	67.1
	14.6
	57.8
	12.1
	44.9
	9.7
	47.1
	10.2
	39.3
	8.6
Diesel fuel	
	119.4
	25.9
	117.8
	24.7
	121.7
	26.3
	118.6
	25.8
	102.9
	22.6
Jet fuel	
	35.8
	7.8
	38.0
	8.0

	42.4
	9.1
	41.8
	9.1
	49.8
	11.0
Petrochemical feedstocks	
	34.5
	7.5
	36.2
	7.6
	28.5
	6.2
	29.0
	6.3
	28.8
	6.3

Total light products	
	431.4
	93.7
	442.8
	92.8
	422.3
	91.2
	419.0
	91.1
	407.3
	89.5
Petroleum coke and sulfur	
	17.8
	3.9
	19.0
	4.0
	33.1
	7.1
	33.4
	7.3
	36.8
	8.1
Residual oil	
	11.3
	2.4
	15.5
	3.2
	8.0
	1.7

7.2

1.6

10.7

2.4

Total production

460.5

100.0

%

477.3

100.0

%

463.4

100.0

%

459.6

100.0

%

454.8

100.0

%

Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001

Overview. Our net loss to common stockholders was $164.3 million ($3.57 per diluted share) in the first nine months of 2002 as compared to net income available to common stockholders of $187.1 million ($5.42 per diluted share) in the corresponding period in 2001. Our operating loss was $162.4 million in the first nine months of 2002 as compared to operating income of $392.2 million in the corresponding period in 2001. Operating income (loss) included pretax refinery restructuring and other charges of $172.9 million and $176.2 million in the first nine months of 2002 and 2001, respectively. Excluding the refinery restructuring and other charges, our operating income was $10.5 million and $568.4 million in the first nine months of 2002 and 2001, respectively. Operating income, excluding the refinery restructuring and other charges, decreased in the first nine months of 2002 compared to the same period in 2001 principally due to significantly weaker market conditions in 2002 than in 2001.

Net Sales and Operating Revenues. Net sales and operating revenues decreased $363.8 million, or 7%, to $4,807.1 million in the first nine months of 2002 from $5,170.9 million in the corresponding period in 2001. This decrease was mainly attributable to lower average product prices in the first nine months of 2002 as compared to

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the same period of 2001. The overall price decline in 2002 reflects the weaker market conditions in 2002 versus the higher product prices mainly observed in the first six months of 2001. This decrease was partially offset by higher product prices in the third quarter of 2002, which we believe were influenced by uncertainties about war with Iraq and associated concerns about future crude oil supply.

Gross Margin. Gross margin decreased $572.9 million to $464.3 million in the first nine months of 2002 from $1,037.2 million in the corresponding period in 2001. This decrease in gross margin was principally driven by significantly weaker market conditions in 2002 than in 2001.

Market

These weak market conditions consisted of significantly weaker crack spreads and crude oil differentials. Beginning in late 2001 and continuing into the third quarter of 2002, on an overall basis, crack spreads have been poor due to weak demand and high levels of distillate and gasoline inventories. This margin environment has been principally driven by a sluggish world economy, significant declines in air travel following the events of September 11, 2001, and an extremely mild 2001/2002 winter. The normal increase in demand for the spring and summer driving season contributed slight improvements to the crack spreads in the second quarter; however, the third quarter again reflected depressed conditions. The Gulf Coast and Chicago crack spreads were approximately 40-50% lower in the first nine months of 2002 than in the corresponding period of 2001. The third quarter of 2001 reflected a decrease from historic highs reached earlier in that year in the Gulf Coast crack spreads as supply shortages from early in the year were addressed with high refinery utilization rates and increased import levels. The Chicago crack spreads did not weaken in proportion to the Gulf Coast crack spreads in the third quarter of 2001 due primarily to supply shortages caused by an unplanned, extended outage at a Chicago refinery, as well as other factors.

The crude oil differentials were also significantly lower in the first nine months of 2002 as compared to the same period in 2001. The crude oil differential between WTI and Maya heavy sour crude oil was approximately 50% lower for the first nine months of 2002 than for the same period last year, and the crude oil differential between WTI and WTS sour crude oil was approximately 60% lower for the first nine months of 2002 than for the same period last year. We believe these narrowed differentials were attributed to OPEC production cutbacks during 2002, which were concentrated in heavy sour and light/medium sour crude oils. This had a significant negative impact on our gross margin because a large proportion of our crude oil throughput is heavy sour and light/medium sour crude oils, which are typically purchased at a discount from WTI, the benchmark crude oil used in industry crack spread calculations. The heavy sour crude oil accounts for between 40% and 45% of our crude oil throughput. Light and medium sour crude oils account for between 21% and 27% of our crude oil throughput. Our gross margin for the first nine months of 2002 was also affected by planned and unplanned downtime at our refineries.

Refinery Operations

In the first nine months of 2002, our Port Arthur refinery experienced crude oil throughput restrictions due to planned turnaround maintenance, unplanned coker repairs, crude supply delays and extreme weather conditions. In the third quarter of 2002, our Port Arthur refinery experienced reduced crude oil throughput rates due to planned delays in crude oil supply resulting from anticipated repairs at the coker unit, which proved to be minimal, and due to unplanned delays in crude oil supply resulting from the impact of production and transportation interruptions caused by hurricanes Isidore and Lili. In the first quarter of 2002, our Port Arthur refinery operations were also affected by the February shutdown of our coker unit for ten days for unplanned maintenance. We took advantage of the coker outage to make repairs to the distillate and naphtha hydrotreaters, including turnaround maintenance that was originally planned for later in the year. Crude oil throughput rates were restricted by approximately 18,000 bpd during this time, but returned to near capacity of 250,000 bpd following the maintenance. In January 2002, we shut down the fluid catalytic cracking (FCC) unit, gas oil hydrotreating unit and sulfur plant for approximately 39 days at our Port Arthur refinery for planned turnaround

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maintenance. This turnaround maintenance did not affect crude oil throughput rates but did lower gasoline production. We sold more unfinished products during the first quarter of 2002 due to this shutdown.

In the first nine months of 2001, crude oil throughput rates at our Port Arthur refinery were restricted due to a lightning strike in early May and restrictions on the crude unit as downstream process units were in start-up operations during the first quarter. The damage from the lightning strike limited the crude unit rate until the crude unit was shutdown in early July for ten days to repair the damage. Following these repairs, the Port Arthur refinery s crude oil throughput rate was close to capacity for the remainder of the quarter.

In the first nine months of 2002, our Lima refinery operations were affected by an unplanned shutdown of the reformer unit in May. The result of the shutdown was the production of non-saleable inventory that was rerun in the later part of the second quarter and into the third quarter resulting in lost economics. Our Lima refinery had a slightly reduced crude oil throughput rate in the third quarter of 2002 due to delays in crude oil delivery caused by the hurricanes mentioned above. In the first nine months of 2001, crude oil throughput rates were below economic capacity at our Lima refinery due to crude oil delivery delays caused by bad weather in the Gulf Coast and a month-long maintenance turnaround on the coker and isocracker units in the first quarter.

Our Hartford refinery operated below capacity as it reduced inventories as it approached its closure date. The Hartford refinery ceased all crude oil processing operations in late September 2002. Crude oil throughput rates were below capacity for the first nine months of 2001 at our Hartford refinery due to coker unit repairs in the first and third quarters. All three refineries operated below economic crude oil throughput capacity during the first nine months of 2002 due to poor refining market conditions.

We continuously aim to achieve excellent safety and health performance. We believe that a superior safety record is inherently tied to achieving our productivity and financial goals. We measure our success in this area primarily through the use of injury frequency rates administered by the Occupational Safety and Health Administration, or OSHA. The recordable injury rate reflects the number of recordable incidents per 200,000 hours worked, and for the nine months ended September 30, 2002, our refineries had the following recordable injury rates: Port Arthur: 1.39; Lima: 1.59; and Hartford: 0.0. The United States refining industry average recordable injury rate for 2001 was 1.35. Despite our efforts to achieve excellence in our safety and health performance, there can be no assurance that there will not be accidents resulting in injuries or even fatalities.

Operating Expenses. Operating expenses decreased $17.6 million to $338.2 million for the first nine months of 2002 from $355.8 million in the corresponding period in 2001. This decrease was principally due to significantly lower natural gas prices partially offset by higher insurance and employee expenses. The higher insurance expenses related to the overall insurance environment after the events of September 11, 2001, and the higher employee expenses related primarily to new benefit plans and higher medical benefit costs for both current and post retirement plans.

General and Administrative Expenses. General and administrative expenses decreased $4.5 million to $40.8 million in the first nine months of 2002 from $45.3 million in the corresponding period in 2001. This decrease included lower wages and benefits partially offset by relocation costs associated with our new Connecticut office. The lower wages related to a restructuring which resulted in a decrease by approximately one third of the administrative positions in our St. Louis office. The lower benefits principally related to lower incentive compensation under our annual incentive program partially offset by higher costs associated with new pension and retirement plans and both current and post retirement employee medical benefit plans.

Stock Option Compensation Expense. Stock option compensation expense was $9.9 million in the first nine months of 2002. During the second quarter of 2002, we elected to adopt the fair value based expense recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). We previously applied the intrinsic value based expense recognition provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). SFAS No. 123 provides that the adoption of the fair value based

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method is a change to a preferable method of accounting. As provided by SFAS No. 123, the stock option compensation expense is calculated based only on stock options granted in the year of election and thereafter. All stock options granted prior to January 1, 2002 continue to be accounted for under APB No. 25.

In the period of adoption of SFAS No. 123, the adoption of this fair value based method increased our net loss by $0.6 million (less than $0.01 per basic share) and $0.8 million (less than $0.01 per basic share) for the three-month and six-month periods ended June 30, 2002, respectively. As provided by SFAS No. 123, the first quarter of 2002 was restated to reflect the adoption of SFAS No. 123. For the three months ended March 31, 2002, the effect of the adoption of SFAS No. 123 on loss from continuing operations and net loss to common stockholders was an additional loss of $0.2 million and $0.01 per common share.

Since nonvested awards issued to employees prior to January 1, 2002 continue to be accounted for using the intrinsic value based provisions of APB No. 25, employee stock-based compensation expense determined using the fair value based method applied prospectively is not necessarily indicative of future expense amounts when the fair value based method will apply to all outstanding nonvested awards. With respect to all stock option grants outstanding at September 30, 2002, the Company will record future non-cash stock option compensation expense and additional paid-in capital of $40.4 million over the applicable vesting periods of the grants.

Refinery Restructuring and Other Charges. In 2002, we recorded refinery restructuring and other charges of $172.9 million, which consisted of the following:

a $137.4 million charge related to the shutdown of refining operations at our Hartford, Illinois refinery,

a $32.4 million charge related to the restructuring of our management team, refinery operations and administrative functions,

income of $5.0 million related to the unanticipated sale of a portion of the Blue Island refinery assets previously written off,

a $2.5 million charge related to the termination of certain guarantees at PACC as part of the Sabine restructuring,

a $1.4 million loss related to the sale of idled assets, and

a $4.2 million write-down of our 5% interest in Clark Retail Group, Inc., the sole stockholder of Clark Retail Enterprises, Inc., or CRE. We acquired an interest in Clark Retail Group, Inc. when PRG sold its retail business to CRE in 1999. Clark Retail Group, Inc. and CRE filed a petition to reorganize under Chapter 11 of the U.S. bankruptcy laws in October 2002.

See further details about the Hartford refinery closure and the management, operations and administrative restructuring below.

In 2001, refinery restructuring and other charges of $176.2 million consisted of a $167.2 million charge related to the January 2001 closure of the Blue Island, Illinois refinery and a $9.0 million charge related to the write-off of idled coker units at our Port Arthur refinery. See Factors Affecting Comparability Closure of Blue Island Refinery for additional discussion of the Blue Island charge and reserve. The write-off of idled coker units at our Port Arthur refinery included a charge of $5.8 million related to the net asset value of the coker units and a $3.2 million charge for future environmental clean-up costs related to the coker unit site.

Hartford Refinery Closure

In late September 2002, we ceased refining operations at our Hartford refinery after concluding there was no economically viable method of reconfiguring the refinery to produce fuels meeting new gasoline and diesel fuel specifications mandated by the federal government. Despite ceasing operations, we continue to pursue all strategic options, including expanding the uses of the petroleum product and distribution facility and selling or leasing the refinery, to mitigate the loss of jobs and refinery capacity in the Midwest.

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Since the Hartford refinery operation had been only marginally profitable over the last 10 years and since substantial investment would be required to meet new required product specifications in the future, our reduced refining capacity resulting from the shutdown is not expected to have a significant negative impact on net income or cash flow from operations. The only anticipated effect on net income and cash flow in the future will result from the actual shutdown process, including recovery of realizable asset value, and subsequent environmental site remediation, which we expect will occur over a number of years. Unless there is a need to adjust the shutdown reserve in the future as discussed below, there should be no significant effect on net income beyond 2002.

A pretax charge of $137.4 million was recorded in 2002, which included $70.7 million of non-cash long-lived asset write-offs to reduce the refinery assets to their estimated net realizable value of $61.0 million. The net realizable value was determined by estimating the value of the assets in a sale or operating lease transaction and was recorded as a current asset on our balance sheet. In October 2002, we announced that we would continue to operate the Hartford terminal facility to accommodate our wholesale petroleum product distribution business. As a result, we reclassified the net book value of the terminal assets from assets held for sale to property, plant and equipment. This reduced the estimated net realizable value of the remaining refinery assets to $49.0 million. We have had preliminary discussions with third parties regarding a transaction for the refinery assets, but there can be no assurance that one will be completed. In the event that a sale or lease transaction is not completed, the net realizable value may be less than $49.0 million and a further write-down may be required. In the second quarter of 2002, we completed an evaluation of our warehouse stock, catalysts, chemicals, and additives inventories, and we determined that a portion of these inventories would not be recoverable upon the closure or sale of the refinery. Accordingly, we wrote-down these assets by $3.2 million.

The total charge also included a reserve for future costs of $62.5 million as itemized below. The Hartford restructuring reserve balance and net cash activity as of September 30, 2002 is as follows:

	Initial Reserve	Net Cash Outlay	Reserve as of September 30, 2002
Employee severance	$ 16.6	$ 0.2	$ 16.4
Plant closure/equipment remediation	12.9	5.6	7.3
Site clean-up/environmental matters	33.0		33.0
	$ 62.5	$ 5.8	$ 56.7

Management adopted an exit plan that details the shutdown of the process units at the refinery and the subsequent environmental remediation of the site. We completed the process unit shutdown and hydrocarbon purging in the fourth quarter of 2002. We terminated approximately 300 of 315 employees, both hourly (covered by collective bargaining agreements) and salaried, in October 2002. The remainder of the employees are expected to be terminated within a year. The site clean-up and environmental reserve takes into account costs that are reasonably foreseeable at this time. As the final disposition of the refinery is determined and a site remediation plan refined, further adjustments of the reserve may be necessary, and such adjustments may be material. We expect to spend approximately $20 million to $30 million in 2002 related to employee severance and the process unit shutdown and hydrocarbon purge.

Finally, the total charge included a $1.0 million reserve related to post-retirement benefits that were extended to certain employees who were nearing the retirement requirements. This liability was recorded in Other Long-term Liabilities on the balance sheet together with our other post-retirement liabilities.

Alleged Asbestos Exposure

We, along with numerous other defendants, have recently been named in approximately 22 individual lawsuits alleging personal injury resulting from exposure to asbestos. A majority of the claims have been filed by employees of third-party independent contractors who purportedly were exposed to asbestos while performing services at our Hartford refinery. We have recently been voluntarily dismissed in 17 of the lawsuits in which we

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have been named. The remainder are in the early stages of litigation. Substantive discovery has not yet been concluded. It is impossible at this time for us to quantify our exposure from these claims, but, based on currently available information, we do not believe that any liability resulting from the resolution of these matters will have a material adverse effect on our consolidated financial position, results of operations or cash flow.

Management, Refinery Operations and Administrative Restructuring

In February 2002, we began the restructuring of our executive management team and subsequently our administrative functions with the hiring of Thomas D. O Malley as chairman, chief executive officer and president and William E. Hantke as executive vice president and chief financial officer. In the first quarter of 2002, as a result of the resignation of the officers who previously held these positions, we recognized severance expense of $5.0 million and non-cash compensation expense of $5.8 million resulting from modifications of stock option terms. In addition, we incurred a charge of $5.0 million for the cancellation of a monitoring agreement with an affiliate of our largest stockholder, Blackstone Management Associates III L.L.C.

In the second quarter of 2002, we commenced a restructuring of our St. Louis-based general and administrative operations and recorded a charge of $6.5 million for severance, outplacement and other restructuring expenses relating to the elimination of 107 hourly and salaried positions. In the third quarter of 2002, we announced plans to reduce our non-represented workforce at our Port Arthur, Texas and Lima, Ohio refineries and make additional staff reductions at our St. Louis administrative office. We recorded a charge of $10.1 million for severance, outplacement, and other restructuring expenses relating to the elimination of 140 hourly and salaried positions. Included in this charge is $1.3 million related to post-retirement benefits that were extended to certain employees who were nearing the retirement requirements. This liability was recorded in Other Long-term Liabilities on the balance sheet together with our other post-retirement liabilities. Reductions at the refineries occurred in October 2002 and those at the St. Louis office will take place by the end of the first quarter of 2003. The reserve related to the refineries and St. Louis restructuring is as follows:

	Initial Reserve	**Additional Reserve**	**Net Cash Outlay**	**Reserve at September 30, 2002**
Refineries and St. Louis restructuring	$ 6.5	$ 8.8	$ 4.6	$ 10.7

We expect to spend approximately $11 million to $13 million in 2002 related to these refinery and St. Louis restructuring activities.

Depreciation and Amortization. Depreciation and amortization expenses decreased $2.8 million to $64.9 million in the first nine months of 2002 from $67.7 million in the corresponding period in 2001. This decrease was principally due to ceasing the recording of depreciation and amortization expense for the Hartford refinery assets beginning in March 2002. This decrease was partially offset by higher amortization expenses at our Lima refinery due to the completion of turnaround activity performed in 2001, and higher amortization at our Port Arthur refinery due to the completion of turnaround activity performed in early 2002.

Interest Expense and Finance Income, net. Interest expense and finance income, net decreased $24.8 million to $81.5 million in the first nine months of 2002 from $106.3 million in the corresponding period in 2001. This decrease related primarily to lower interest expense due to the repurchase of certain debt securities in 2001 and 2002 and lower interest rates on our floating rate debt. The decrease was partially offset by lower interest income as cash balances declined.

Gain or Loss on Extinguishment of Long-term Debt. In the first nine months of 2002, we recorded a loss on extinguishment of long-term debt of $19.5 million related to the redemption of certain long-term debt. This loss included premiums associated with the early repayment of long-term debt of $9.4 million, a write-off of unamortized deferred financing costs related to this debt of $9.5 million, and the write-off of a prepaid premium for an insurance policy guaranteeing the interest and principal payments on Sabine s long-term debt of $0.6 million.

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In the first nine months of 2001, we repurchased in the open market $21.3 million in face value of our 9½% senior notes, $30.6 million in face value of our 10 7/8% senior notes, and $5.9 million in face value of our 11½% exchangeable preferred stock. As a result of these transactions, we recorded a gain of $8.7 million, which included discounts of $9.3 million offset by the write-off of deferred financing costs related to the notes.

Income Tax (Provision) Benefit. We recorded a $99.9 million income tax benefit in the first nine months of 2002 as compared to an income tax provision of $78.7 million in the corresponding period in 2001. The income tax provision of $78.7 million for 2001 included the effect of a $30.0 million decrease in the deferred tax valuation allowance. During the first quarter of 2001, we reversed our remaining deferred tax valuation allowance as a result of the analysis of the likelihood of realizing the future tax benefit of our federal and state tax loss carryforwards, alternative minimum tax credits and federal and state business tax credits.

As of September 30, 2002, we had a net deferred tax asset of $78.8 million recorded on our balance sheet. SFAS No. 109, Accounting for Income Taxes, requires that deferred tax assets be reduced by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. When applicable a valuation allowance should be recorded to reduce the deferred tax asset to the amount that is more likely than not to be realized. As a result of the analysis of the likelihood of realizing the future tax benefit of our federal and state tax loss carryforwards, alternative minimum tax credits and federal and state business tax credits, we have not provided a valuation allowance related to the net deferred tax asset. The likelihood of realizing the net deferred tax asset is analyzed on a regular basis and should it be determined that it is more likely than not that some portion or all of the net deferred tax asset will not be realized, a tax valuation allowance and a corresponding income tax provision would be required at that time.

Future changes, even slight changes, in the ownership of our common stock (including, among other things, the exercise of compensatory options) could result in an aggregate change in ownership of more than 50% for purposes of Section 382 of the Internal Revenue Code, which could substantially limit the availability of our net operating loss carryforwards, other losses and tax credits.

Discontinued Operations. In 2001, we recorded a pretax charge of $14.0 million, $8.5 million net of income taxes, related to environmental liabilities of discontinued retail operations. This charge represented an increase in estimates regarding our environmental clean up obligation and was prompted by the availability of new information concerning site by site clean up plans and changing postures of state regulatory agencies.

2001 Compared to 2000

Overview. Net income available to common stockholders increased $62.5 million, or 78%, to $142.6 million in 2001 from $80.1 million in 2000. Operating income increased $220.3 million to $367.0 million in 2001 from $146.7 million in 2000. Excluding non-recurring restructuring and other charges of $176.2 million in 2001, operating income increased $396.5 million in 2001 compared to 2000. This increase was principally due to the completion and operation of the heavy oil upgrade project at our Port Arthur refinery, combined with continued strong market conditions.

Net Sales and Operating Revenues. Net sales and operating revenues decreased by $884.2 million, or 12%, to $6,417.5 million in 2001 from $7,301.7 million in 2000. This decrease was principally attributable to steep declines in petroleum product prices in the second half of the year, particularly after the September 11th terrorist attacks, and to our shutdown of the Blue Island, Illinois refinery in January 2001.

Gross Margin. Gross margin increased by $426.9 million, or 58%, to $1,166.1 million in 2001 from $739.2 million in 2000. This increase was principally due to the processing of a greater quantity of less expensive heavy sour crude oil at our Port Arthur refinery, significant discounts on sour and heavy sour crude oil, strong gasoline and distillate market conditions, especially in the first half of the year, as well as solid performance by

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our refineries. These gains were partially offset by poor market conditions in the fourth quarter and plant downtime and operational issues as described below.

The improvement in crude oil discounts was reflected in the increase in the average sour and heavy sour crude oil differentials to West Texas Intermediate. The completion of the heavy oil upgrade project at our Port Arthur refinery has positioned us to maximize the improved crude oil differentials, having processed heavy sour crude oil equal to 43% of total crude oil throughput in 2001 compared to 13% of heavy sour crude oil in 2000. The improved crude oil differentials and the increase in usage of heavy sour crude oil together contributed over $450 million to gross margin in 2001. Margins for light products such as gasoline and distillates remained strong in the first six months of 2001 due to the continued tight supply and demand balance. Industry inventories remained at low levels through most of the first six months of 2001 and were further lowered by industry-wide maintenance turnarounds performed in the first quarter. The improvement in gasoline and distillate margins was reflected by increases in the Gulf Coast and Chicago crack spreads. In the second half of the year, the Gulf Coast and Chicago crack spreads weakened as gasoline and distillate inventory levels increased due to high refinery utilization rates, high import levels, and unseasonably low demand. The lower demand was driven by decreases in air travel after the September 11th terrorist attacks, a weak industrial sector, a general downturn in the economy, and mild winter weather. Due primarily to significant unplanned downtime experienced by other Midwest refiners, the Chicago crack spread did not weaken in proportion to the Gulf Coast crack spread through the third quarter. The Chicago crack spread decreased significantly during the fourth quarter as product was imported into the region due to the higher margins. Overall, crack spreads in 2001 remained above prior year levels.

Excluding the Blue Island refinery s results, our crude oil throughput rate was higher in 2001 as compared to 2000. Overall, our refineries ran well in 2001 with some planned maintenance shutdowns and restrictions and a few unplanned restrictions of our crude and other units. The crude oil throughput rate at our Port Arthur refinery of 229,800 bpd was below capacity of 250,000 bpd in 2001 because units downstream were in start-up operations during the first quarter and a lightning strike in early May 2001 limited the crude unit rate until the crude unit was shut down in early July for ten days to repair the damage caused by the lightning strike. The Port Arthur refinery also experienced a slightly reduced crude oil throughput rate late in the fourth quarter due to minor repairs of the coker and crude units. In March 2001, the Lima refinery performed a planned month-long maintenance turnaround on its coker and isocracker units, and in November 2001 it performed a planned seven-day maintenance turnaround on its crude and other units. The Lima refinery also experienced crude oil supply delays caused by bad weather in the Gulf Coast. Our Hartford refinery experienced ten days of unplanned downtime for coker unit repairs early in the year and planned restricted utilization of the coker unit late in the year due to minor repairs and a shutdown of a third party sulfur plant utilized by Hartford.

Operations in 2000 were affected by the planned month-long maintenance turnaround and subsequent 11-day unscheduled downtime of the Port Arthur refinery crude unit, planned restrictions at all refineries due to weak margin conditions early in the year, unplanned downtime at the Lima refinery due to two electrical outages and a failed compressor, unplanned downtime at the Blue Island refinery requiring maintenance on its vacuum and crude unit, and crude oil supply disruptions to all of the plants late in the year.

Operating Expenses. Operating expenses remained the same at $467.7 million for both 2001 and 2000. Operating expenses benefited significantly in 2001 from the lack of eleven months of operating expenses for the Blue Island refinery in 2001 due to its closure in late January. Offsetting this decrease, however, were higher costs at our Port Arthur refinery for the operation of the new heavy oil processing units, higher energy costs at our Port Arthur refinery, and additional repair and maintenance costs at our Hartford refinery.

General and Administrative Expenses. General and administrative expenses increased $10.3 million, or 19%, to $63.3 million in 2001 from $53.0 million in 2000. This increase was principally due to higher incentive compensation under our annual incentive plan, expenses related to the planning, design and implementation of a new financial and commercial information system, and new support services for the heavy oil processing facility.

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Refinery Restructuring and Other Charges. The refinery restructuring and other charges consisted of a $167.2 million charge related to the January 2001 closure of the Blue Island refinery and a $9.0 million charge related to the write-off of idled coker units at the Port Arthur refinery. See Factors Affecting Comparability Closure of Blue Island Refinery for additional discussion of the Blue Island charge. The write-off of idled coker units at our Port Arthur refinery included a charge of $5.8 million related to the net asset value of the coker units and a $3.2 million charge for future environmental clean-up costs related to the site. We now believe that an alternative use of the coker units is not probable.

Depreciation and Amortization. Depreciation and amortization expenses increased $20.1 million, or 28%, to $91.9 million in 2001 from $71.8 million in the corresponding period in 2000. This increase was principally due to depreciation on the new units associated with the heavy oil upgrade project. We began depreciating these assets in accordance with our property, plant and equipment policy during the first quarter of 2001 following substantial completion of the heavy oil upgrade project and commencement of operations. Amortization contributed to the increase due to a major 2000 Port Arthur refinery turnaround and a first quarter 2001 Lima refinery turnaround.

Interest Expense and Finance Income, net. Interest expense and finance income, net increased by $57.3 million, or 70%, to $139.5 million in 2001 from $82.2 million in 2000. In 2000, the majority of the interest costs on the 12½% senior notes and the senior secured bank loan of our subsidiary, PAFC, were capitalized as part of the heavy oil upgrade project. These costs are now expensed as a result of the commencement of operations in early 2001. Offsetting a portion of this increase were lower interest rates on our floating rate loans.

Gain on Extinguishment of Long-term Debt. In the third quarter of 2001, we repurchased in the open market $21.3 million in face value of our 9½% senior notes, $30.6 million in face value of our 10 $^{7}/8$% senior notes, and $5.9 million in face value of our 11½% exchangeable preferred stock. As a result of these transactions, we recorded a gain of $8.7 million, which included discounts of $9.3 million offset by the write-off of deferred financing costs related to the notes.

Income Tax (Provision) Benefit. The income tax provision increased $78.2 million to $52.4 million in 2001 from a tax benefit of $25.8 million in the corresponding period in 2000. The income tax provision of $52.4 million in 2001 consisted of a provision on income from continuing operations partially offset by the complete reversal of the remaining tax valuation allowance of $30.0 million. The income tax benefit of $25.8 million in 2000 included a reversal of a portion of our tax valuation allowance of $50.8 million partially offset by a provision on income. In September 2001, we made a federal estimated income tax payment of $13.0 million.

Our pretax earnings for financial reporting purposes in the future will generally be fully subject to income taxes, although our actual cash payment of taxes is expected to benefit from regular tax and alternative minimum tax net operating loss carryforwards available at December 31, 2001 of approximately $246 million and $186 million, respectively. Future changes, even slight changes, in the ownership of our common stock (including, among other things, the exercise of compensatory options) could result in an aggregate change in ownership of more than 50% for purposes of Section 382 of the Internal Revenue Code, which could substantially limit the availability of our net operating loss carryforwards, other losses and tax credits.

Discontinued Operations. In 2001, we recorded an additional pretax charge of $29.5 million (net of income taxes $18.0 million) related to the environmental and other liabilities of the discontinued retail operations. See Factors Affecting Comparability Sale of Retail Division for additional discussion of this charge.

2000 Compared to 1999

Overview. Net income available to common stockholders increased by $125.1 million to net income available to common stockholders of 80.1 million in 2000 from a net loss to common stockholders of $45.0 million in 1999. Operating income increased $137.6 million to $146.7 million in 2000 from $9.1 million in 1999.

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Excluding the $105.8 million recovery of a non-cash inventory charge in 1999, operating income increased by $243.4 million in 2000 compared to 1999. This increase was principally due to strong market conditions throughout most of 2000, as evidenced by the change in the Gulf Coast crack spread, which increased from $1.71 per barrel in 1999 to $4.17 per barrel in 2000 and improved sour and heavy sour crude oil differentials.

Net Sales and Operating Revenues. Net sales and operating revenues increased $2,781.2 million, or 62%, to $7,301.7 million in 2000 from $4,520.5 million in 1999. This increase was principally due to higher petroleum prices, as production remained steady. Our average sales price per barrel increased by approximately $14 per barrel for the full year 2000 versus 1999.

Gross Margin. Gross margin increased $318.5 million, or 76%, to $739.2 million in 2000 from $420.7 million in 1999. This increase was principally due to continued strong refined product conditions, particularly for gasoline and distillate margins, and strong operational performance at our refineries in the second half of the year. These significant improvements were partially offset by poor margins on heavier products such as petroleum coke and asphalt due to higher import costs, planned and unplanned downtimes at our refineries, and negative inventory management results.

Market conditions for 2000 started improving over prior year levels during the first quarter and remained above prior year levels for the rest of the year, reaching record levels to date during the second quarter. The main contributor to the higher gross margin was the improvement in gasoline and distillate margins, which were reflected in significant increases in the average Gulf Coast and Chicago crack spreads. We believe these improved market conditions were due mainly to low domestic inventory levels, solid demand, the mandated introduction of a new summer-grade reformulated gasoline, and pipeline supply disruptions. Crude oil discounts for heavier and sour crude oils improved over the prior year, also contributing to gross margin, as evidenced by the improved sour and heavy sour crude oil differentials. These benefits were partially offset by poor heavy product margins as prices for products such as petroleum coke and residual fuel did not track the high feedstock prices in the period.

Major scheduled maintenance turnarounds at our Port Arthur refinery in 2000 and our Lima refinery in 1999 resulted in an opportunity cost from lost production of $30 million in 2000 and $23 million in 1999. In 2000, our Port Arthur refinery crude oil throughput rates were reduced in the first quarter due to problems with the FCC unit, and significantly lowered in the second quarter due to a scheduled turnaround and unscheduled downtime of the crude unit. The work performed during the scheduled turnaround expanded the crude unit capacity from 232,000 bpd to 250,000 bpd and readied the unit to process up to 80% heavy sour crude oil as part of the heavy oil upgrade project. In the third and fourth quarters, the crude oil throughput rate was near its new capacity of 250,000 bpd except for some minor crude oil availability problems in the fourth quarter due to bad weather. Crude oil throughput rates at our Port Arthur refinery were reduced below capacity in 1999 due to poor economic conditions. Crude oil throughput in 2000 was higher than in 1999 at our Lima and Hartford refineries. This was principally because both refineries had solid performance, with only short unplanned downtimes and reduced rates early in 2000 due to poor economic conditions and late in 2000 due to crude oil supply disruptions. Blue Island refinery crude oil throughput rates for 2000 were lower than 1999 due to unplanned downtimes and crude oil supply disruptions.

Our gross margin in 2000 was significantly reduced as a result of negative inventory management results. We incurred losses of approximately $73 million from hedging inventory positions in excess of our target inventory position levels in a backwardated market. Backwardation refers to the time structure of the futures market when the price of a commodity in the current month is higher than the price in the future. This creates an embedded hedging cost as short futures positions are closed, if prices are higher than the hedged price. The inventory position was over target because of the effects of unplanned refinery downtime early in the year, the timing of fixing crude oil price commitments and the fact that, for much of the year, we were hedging to a target inventory level that was not appropriate. The financial effects of inventory management in 1999 were marginally positive.

Operating Expenses. Operating expenses increased $64.9 million, or approximately 16%, to $467.7 million in 2000 from $402.8 million in 1999. This increase was principally due to higher energy and repair and maintenance costs. The average natural gas price increase of $1.69 per million btu, an increase of 75% over 1999 prices, reflected the increase in energy cost. In addition, our Port Arthur refinery incurred higher repair and maintenance costs in conjunction with the planned turnaround and subsequent unscheduled downtime of its crude unit.

General and Administrative Expenses. General and administrative expenses increased $1.5 million, or approximately 3%, to $53.0 million in 2000 from $51.5 million in 1999. This slight increase was due to higher incentive compensation under our annual incentive plan, offset in part by lower wholesale costs due to the sale of the terminals, the absence of year 2000 systems remediation costs, and the absence of start-up costs related to the initial financing of the heavy oil upgrade project.

Depreciation and Amortization. Depreciation and amortization increased $8.7 million, or approximately 14%, to $71.8 million in 2000 from $63.1 million in 1999. This increase was principally due to the full year impact of a Lima maintenance turnaround performed in 1999 and higher capital expenditures.

Interest Expense and Finance Income, net. Interest expense and finance income, net decreased $9.3 million, or approximately 10%, to $82.2 million in 2000 from $91.5 million in 1999. Of this decrease, $7.6 million related to the absence in 2000 of start-up costs associated with the initial financing of the heavy oil upgrade project. For both 2000 and 1999, the majority of the interest expense from the debt incurred to finance the heavy oil upgrade project was capitalized as part of the project. The remainder of the decrease was due to higher interest income on invested cash balances which more than offset the higher interest expense due to higher interest rates on our $240 million floating rate term loan.

Income Tax Benefit. The income tax benefit increased $13.8 million to $25.8 million in 2000 from $12.0 million in 1999. The income tax benefit of $25.8 million in 2000 represented a decrease in a deferred tax valuation allowance of $50.8 million, partially offset by a provision on income from continuing operations. The income tax benefit of $12.0 million in 1999 reflected the effect of intra-period tax allocations resulting from the utilization of current year operating losses to offset the net income of the discontinued retail division, partially offset by the write-down of a net deferred tax asset.

Discontinued Operations. We reported the results of our retail marketing business that we sold in 1999, which consisted of a loss of $4.3 million, net of an income tax benefit of $2.7 million, and the gain on the sale of the business of $36.9 million, net of income tax provision of $23.7 million, as discontinued operations in 1999.

Outlook

The forward-looking statements made in this Outlook section, as well as any forward-looking statements within other sections of this prospectus, reflect our expectations regarding future events as of the date of the filing of this prospectus, but do not reflect the acquisition of the Memphis refinery. Words such as expects, intends, plans, projects, believes, estimates, will and similar expressions typically identify such forwa statements. Even though we believe our expectations regarding future events are based on reasonable assumptions, forward-looking statements are not guarantees of future performance. For example, set forth in the Refinery Operations section below, we discuss our expectations regarding the performance of our Port Arthur and Lima refineries for the fourth quarter of 2002. Despite our expectations, factors beyond our control such as the reliability and efficiency of our operating facilities, the impact of severe weather, crude oil supply interruptions, and acts of war or terrorism could result in restricted operations, unplanned downtime, and other unanticipated results. See Risk Factors for an expanded list of the factors that could cause actual results to differ materially from our current expectations.

Market. Crack spreads and crude oil differentials in the fourth quarter of 2002 improved over the results of the prior three quarters. The average Gulf Coast and Chicago crack spreads increased 27% and 36%, respectively, for the fourth quarter of 2002 over the average of the first nine months of 2002. We believe these margins were principally driven by production and transportation interruptions due to hurricanes Isidore and Lili at the beginning of the quarter. Crude oil differentials also improved in the quarter, increasing by approximately 25% for the fourth quarter of 2002 over the average for the first nine months of 2002.

Gross Margin. It is common practice in our industry to look to benchmark market indicators as a predictor of actual refining margins. For example, the 3/2/1 benchmark crack spread models a refinery that consumes WTI sweet crude oil and produces roughly 66% regular gasoline and 33% high sulfur distillate. To improve the reliability of this benchmark as a predictor of actual refining margins, it must first be adjusted for a crude oil slate that is not 100% light and sweet. Secondly, it must be adjusted to reflect variances from the benchmark product slate to the actual, or anticipated, product slate. Lastly, it must be adjusted for any other factors not anticipated in the benchmark, including ancillary crude and product costs such as transportation, storage and credit fees, inventory fluctuations and price risk management activities.

Our Port Arthur refinery has historically produced roughly equal parts gasoline and distillate. For this reason, we believe the Gulf Coast 2/1/1 crack spread more closely reflects our product slate than the Gulf Coast 3/2/1 crack spread. However, approximately 15% of Port Arthur s product slate is lower value petroleum coke and residual oils which will negatively impact the refinery s performance against the benchmark crack spread.

Port Arthur s crude oil slate is approximately 80% Maya heavy sour crude oil and 20% medium sour crude oil. Accordingly, the WTI/Maya and WTI/WTS crude oil differentials can be used as an adjustment to the benchmark crack spread. As discussed elsewhere in this prospectus, we will not receive any discounts on our purchases of Maya crude oil under our long-term crude oil supply agreement through the balance of 2002. Ancillary crude costs, primarily transportation, at Port Arthur averaged $0.95 per barrel of crude oil throughput for the first nine months of 2002. Our reformer unit was down for repairs for approximately two weeks during late October and early November and crude oil throughput rates were restricted during this period. No significant downtime is planned for our Port Arthur refinery for the balance of 2002, and we expect crude oil throughput rates in the fourth quarter of 2002 to continue at, or near, their year-to-date rate in 2002.

Our Lima refinery has a product slate of approximately 60% gasoline and 30% distillate and we believe the Chicago 3/2/1 is an appropriate benchmark crack spread. This refinery consumes approximately 95% light sweet crude oil with the balance being light sour crude oils. We opportunistically buy a mix of domestic and foreign sweet crude oils. The foreign crude oils consumed at Lima are priced relative to Brent and the WTI/Brent differential can be used to adjust the benchmark. Ancillary crude costs for Lima averaged $1.49 per barrel of crude throughput for the first nine months of 2002. In the fourth quarter of 2002, the Lima refinery shutdown its reformer unit for approximately 10 days for repairs, which restricted crude oil throughput rates as well as other unit operations. However, crude oil throughput in the fourth quarter of 2002 is expected to remain at or above year-to-date levels.

Operating Expenses. Natural gas is the most variable component of our operating expenses. On an annual basis, our refineries consume approximately 26.7 million mmbtu of natural gas. Excluding the Hartford refinery, we anticipate this usage will be 21.9 million mmbtu. In a normalized natural gas pricing environment and assuming average crude oil throughput levels, our annual operating expenses should range between $450 million and $475 million. The closure of the Hartford refinery is expected to reduce this amount to between $360 million and $380 million.

General and Administrative Expenses. During 2002, we restructured our general and administrative operations to reduce our overhead costs. As part of these cost reductions we have indefinitely suspended our Senior Executive Retirement Plan, or SERP, and the plan participants have consented to the suspension. In addition, Mr. O Malley has voluntarily agreed to reduce his annual salary by 40% from $500,000 to $300,000.

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Mr. O Malley may reinstate his previous annual salary by giving 30 days notice to us. The SERP may be reinstated with approval of our board of directors. We expect the restructuring to be completed by the end of the first quarter of 2003, and we expect our general and administrative expenses to total approximately $38 million for 2003.

We recognize non-cash, stock option compensation expense computed under SFAS No. 123. As of September 30, 2002, we had incurred $9.9 million in stock option compensation expense for all stock options granted to date in 2002, representing 77% of all stock options currently outstanding. We expect to record approximately $4.2 million per quarter for nine more quarters, reflecting the remaining vesting period for the outstanding 2002 options granted to date. Future stock option grants will be expensed pursuant to the recognition provisions of SFAS No. 123.

Insurance Expense. We carry insurance policies on insurable risks, which we believe to be appropriate at commercially reasonable rates. While we believe that we are adequately insured, future losses could exceed insurance policy limits or, under adverse interpretations, be excluded from coverage. Future costs, if any, incurred under such circumstances would have to be paid out of general corporate funds.

The Company s major insurance policies renewed on October 1, 2002 with a one-year term. Due primarily to the continuing effects of the events of September 11, 2001 on the insurance market, certain coverage terms, including terrorism coverage, were restricted or eliminated at renewal, certain deductibles were raised, certain coverage limits were lowered, and overall premium rates increased by 23%. Higher insurance premium expenses will be reflected in our results beginning in the fourth quarter.

Depreciation and Amortization. Depreciation and amortization expense for the third quarter of 2002 was $20.8 million and excludes the Hartford refinery, which has been accounted for as an asset held for sale. This amount will increase in future periods based upon capital expenditure activity. Included in this amount is the amortization of our turnaround costs, generally over four years.

Interest Expense. Based on our outstanding long-term debt at September 30, 2002, our annual gross interest expense is approximately $85 million. All of our debt is at fixed rates with the exception of $240 million in floating rate notes tied to LIBOR. Reported interest expense is reduced by capitalized interest.

Income Taxes. Our effective tax rate for the nine months ended September 30, 2002 was 37.9% Our effective tax rate for the fourth quarter of 2002 was lower than the rate for the first nine months of the year, primarily due to business tax credits. Our effective tax rate in 2003 should approximate 37% to 38%.

Capital Expenditures and Turnarounds. Capital expenditures and turnarounds for the first nine months of 2002 totaled $97.5 million. We spent $38.1 million in the fourth quarter of 2002 and plan to spend approximately $175 million in 2003. We plan to fund capital expenditures with internally generated funds. However, if the average market environment experienced in the first nine months of 2002 continues, this plan may not be practicable and we are reevaluating the scope and timing of our capital expenditures plan.

Liquidity and Capital Resources

Cash Balances

As of September 30, 2002, we had a cash and short-term investment balance of $158.0 million. In addition, under an amended common security agreement related to PAFC s senior debt, PACC is required to restrict $45.0 million of cash for debt service at all times plus restrict an amount equal to the next scheduled principal and interest payment, prorated based on the number of months remaining until that payment is due. As of September 30, 2002, cash of $51.9 million was restricted under these requirements.

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We maintain a directors and officers insurance policy, which insures our directors and officers from any claim arising out of an alleged wrongful act by such persons in their respective capacities as directors and officers. Pursuant to indemnity agreements between us and each of our directors and officers, we have formed a captive insurance subsidiary, Opus Energy, to provide additional financial coverage for such claims. We have funded an initial $3.0 million and have committed to funding $1 million annually until a loss fund of $10 million is established.

As of December 31, 2001, we had cash, cash equivalents and short-term investments of $511.8 million. Under a common security agreement related to our senior debt at PAFC, PACC s cash of $222.8 million was reserved under a secured account structure for specific operational uses and mandatory debt repayment. The operational uses included various levels of spending, such as current and operational working capital needs, interest and principal payments, taxes, and maintenance and repairs. Cash was applied to each level until that level had been fully funded, upon which the remaining cash flowed to the next level. Once these spending levels were funded, the remaining cash surplus satisfied obligations of a debt service reserve and mandatory debt prepayment with funding occurring semiannually on January 15th and July 15th. On January 15, 2002, PACC used $59.7 million of cash to make a mandatory prepayment of debt under the senior secured bank loan. In addition, as of December 31, 2001, PACC had $30.8 million of cash and cash equivalents restricted for debt service, which included principal of $6.5 million and interest of $24.3 million due in January 2002. These PACC cash restrictions were significantly modified and the secured account structure eliminated in June 2002 under the amended and restated common security agreement due to the Sabine restructuring as explained above.

Cash Flow from Operating Activities

Net cash used in operating activities for the nine months ended September 30, 2002 was $42.2 million compared to net cash provided from operations of $390.2 million in the corresponding period of 2001. The use of cash for operating activities in 2002 as compared to the provision of cash from operations in 2001 is mainly attributable to weak market conditions, which resulted in poor operating results. Working capital as of September 30, 2002 was $291.7 million, a 1.51-to-1 current ratio, versus $482.6 million as of December 31, 2001, a 1.83-to-1 current ratio. The decrease in working capital included the use of approximately $203 million of available cash, excluding initial public offering proceeds, to repay long-term debt. Our cash investment in hydrocarbon working capital at September 30, 2002 remained approximately $50 million above our normalized operating level due primarily to timing of crude oil purchases and product receipts. This incremental investment is believed to be recoverable in the ordinary course of business.

We have increased our reserve for uncollectible accounts receivable to $3.2 million primarily in response to increased risk with respect to our wholesale customers caused by the continued downturn of the U.S. economy.

In 1999, we sold crude oil linefill in the pipeline system supplying the Lima refinery to Koch Supply and Trading L.P. or Koch. As part of the agreement with Koch, we were required to repurchase approximately 2.7 million barrels of crude oil in this pipeline system in September 2002. On October 1, 2002, Morgan Stanley Capital Group Inc., or MSCG, purchased the 2.7 million barrels of crude oil from Koch in lieu of our purchase obligation. We have agreed to purchase those barrels of crude oil from MSCG upon termination of our agreement with them, at then current market prices as adjusted by certain predetermined contract provisions. The initial term of the contract continues until October 1, 2003, and thereafter automatically renews for additional 30-day periods unless terminated by either party. We have hedged the economic price risk related to the repurchase obligation through the purchase of exchange-traded futures contracts.

Clark Retail Group, Inc. and its wholly owned subsidiary, CRE, filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code on October 15, 2002. As part of PRG s sale of its retail business to CRE in July 1999, PRG assigned approximately 170 leases and subleases of retail stores to CRE. PRG remains jointly and severally liable for CRE s obligations under approximately 150 of those leases, including payment of rent, taxes and environmental cleanup responsibilities for releases of petroleum occurring during the term of the

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leases. Should CRE reject some or all of these leases, PRG may become responsible for these obligations. We are currently evaluating what the financial impact on us will be if PRG is forced to assume liability for the rent and cleanup obligations under a significant number of these leases. Should any of these leases revert to PRG, we will attempt to reduce the potential liability by subletting or reassigning the leases.

Net cash provided by operating activities for the year ended December 31, 2001 was $439.2 million compared to $124.4 million for the year ended December 31, 2000 and $85.5 million for the year ended December 31, 1999. Cash flow from operating activities for the year ended December 31, 2000 and 2001 were mainly impacted by the improvement in cash earnings. Cash flow from operating activities for the year ended December 31, 1999 were mainly impacted by a significant working capital benefit offset by the effects of poor refining margins on cash earnings. Working capital as of December 31, 2001 was $482.6 million, a 1.83:1 current ratio, compared to $325.0 million as of December 31, 2000, a 1.51:1 current ratio.

As of December 31, 2001, our future minimum lease payments under non-cancelable operating leases were as follows (in millions): 2002 $8.0, 2003 $7.4, 2004 $6.0, 2005 $5.7, 2006 $5.3, and $3.6 in the aggregate thereafter.

Cash Flow from Investing Activities

Cash flow used in investing activities for the nine months ended September 30, 2002 were $91.8 million as compared to $98.5 million in the year-earlier period. Activity in both the nine months ended September 30, 2002 and 2001 primarily reflect capital expenditures. We classify our capital expenditures into two main categories, mandatory and discretionary. Mandatory capital expenditures, such as for turnarounds and maintenance, are required to maintain safe and reliable operations or to comply with regulations pertaining to soil, water and air contamination or pollution and occupational, safety and health issues. We estimate that total mandatory capital and turnaround expenditures will average approximately $100 million per year for 2002 through 2006. This estimate includes the capital costs necessary to comply with environmental regulations, except for Tier 2 gasoline standards, on-road diesel regulations and the MACT II regulations described below. Our total mandatory capital and refinery maintenance turnaround expenditure budget, excluding Tier 2 gasoline standards, on-road diesel regulations and the MACT II regulations described below, is approximately $65 million in 2002, of which $56.8 million has been spent as of September 30, 2002. Our total mandatory capital and refinery maintenance turnaround expenditure budget is approximately $85 million for 2003. Discretionary capital expenditures are undertaken by us on a voluntary basis after thorough analytical review and screening of projects based on the expected return on incremental capital employed. Discretionary capital projects generally involve an expansion of existing capacity, improvement in product yields and/or a reduction in operating costs. Accordingly, total discretionary capital expenditures may be less than budget if cash flow is lower than expected and higher than budget if cash flow is better than expected. Our discretionary capital expenditure budget is approximately $30 million in 2002, of which $15.2 million has been spent as of September 30, 2002. Our discretionary capital expenditure budget is approximately $5 million for 2003. We plan to fund both mandatory and discretionary capital expenditures for 2002 with available cash and cash flow from operations.

In addition to mandatory capital expenditures, we expect to incur in the aggregate approximately $545 million through 2006 in order to comply with environmental regulations discussed below. The Environmental Protection Agency, or EPA, has promulgated new regulations under the Clean Air Act that establish stringent sulfur content specifications for gasoline and on-road diesel fuel designed to reduce air emissions from the use of these products.

Tier 2 Motor Vehicle Emission Standards. In February 2000, the EPA promulgated the Tier 2 Motor Vehicle Emission Standards Final Rule for all passenger vehicles, establishing standards for sulfur content in gasoline. These regulations mandate that the average sulfur content of gasoline for highway use produced at any refinery not exceed 30 ppm during any calendar year by January 1, 2006, phasing in beginning on January 1, 2004. We currently expect to produce gasoline under the new sulfur standards at the Port Arthur refinery prior to

January 1, 2004 and, as a result of the corporate pool averaging provisions of the regulations, will not be required to meet the new sulfur standards at the Lima refinery until July 1, 2004, a six month deferral. A further delay in the requirement to meet the new sulfur standards at the Lima refinery through 2005 may be possible through the purchase of sulfur allotments and credits which arise from a refiner producing gasoline with a sulfur content below specified levels prior to the end of 2005, the end of the phase-in period. There is no assurance that sufficient allotments or credits to defer investment at our Lima refinery will be available, or if available, at what cost. We believe, based on current estimates and on a January 1, 2004 compliance date for both the Port Arthur and Lima refineries, that compliance with the new Tier 2 gasoline specifications will require capital expenditures in the aggregate through 2005 of approximately $255 million, an increase of $79 million from 2001 year-end estimates. We have completed detailed engineering studies that have resulted in revised cost estimates based on refined implementation plans. Future revisions to these cost estimates may be necessary. More than 95% of the total investment to meet the Tier 2 gasoline specifications is expected to be incurred during 2002 through 2004 with the greatest concentration of spending occurring in 2003.

Low Sulfur Diesel Standards. In January 2001, the EPA promulgated its on-road diesel regulations, which will require a 97% reduction in the sulfur content of diesel fuel sold for highway use by June 1, 2006, with full compliance by January 1, 2010. Regulations for off-road diesel requirements are pending. We estimate that capital expenditures required to comply with the on-road diesel standards at our Port Arthur and Lima refineries in the aggregate through 2006 is approximately $245 million, an increase of $20 million from previous estimates. The revised estimate is based on additional engineering studies and may be revised further as we move towards finalization of our implementation strategy. More than 95% of the projected investment is expected to be incurred during 2004 through 2006 with the greatest concentration of spending occurring in 2005. Since the Lima refinery does not currently produce diesel fuel to on-road specifications, we are considering an acceleration of the low-sulfur diesel investment at the Lima refinery in order to capture this incremental product value. If the investment is accelerated, production of the low-sulfur fuel is possible by the first quarter of 2005.

Maximum Achievable Control Technology. On April 11, 2002, the EPA promulgated regulations to implement Phase II of the petroleum refinery Maximum Achievable Control Technology rule under the federal Clean Air Act, referred to as MACT II, which regulates emissions of hazardous air pollutants from certain refinery units. We expect to spend approximately $45 million in the next three years related to these new regulations with the greatest concentration of spending evenly spread out over 2003 and 2004. We are performing some tests at our Lima refinery that will determine if we currently meet the MACT II standards. If the tests confirm this compliance then our MACT II spending can be reduced to $25 million. We should know the results of these tests for our year-end 2002 reporting.

Our budget for complying with Tier 2 gasoline standards, on-road diesel regulations and the MACT II regulations is approximately $64 million in 2002, of which $25.5 million has been spent as of September 30, 2002. Our budget for complying with these regulations is approximately $86 million for 2003. It is our intention to fund expenditures necessary to comply with these new environmental standards with cash flow from operations. However, if the average market environment experienced in the first nine months of 2002 continues, it may not be possible for us to generate sufficient cash flow from operations to meet these obligations. Accordingly, we are evaluating our implementation plans.

In conjunction with the work being performed to comply with the above regulations, we have initiated a project to expand the Port Arthur refinery to 300,000 400,000 barrels per day of crude oil throughput capacity. A feasibility study is underway and the ultimate scope and outcome of this project has yet to be determined. We are also evaluating projects to reconfigure the Lima refinery to process a more sour and heavier crude slate. This initiative is in a very preliminary stage.

Cash flow used in investing activities for the year ended December 31, 2001 were $152.9 million as compared to $375.3 million for the year ended December 31, 2000 and $321.3 million for the year ended December 31, 1999. The years ended December 31, 2000 and 1999 reflected higher capital expenditures related to the heavy oil upgrade project. Net cash flow provided by investing activities in 1999 included the sale of the retail division for $214.8 million and the sale of the terminals for $33.7 million.

Capital expenditures for the year ended December 31, 2001 were $296.2 million lower than the same period in 2000, principally due to the completion of the construction of the refinery upgrade project. Turnaround costs increased $17.7 million in 2001 due to expenditures in 2001 for planned maintenance at the Port Arthur and Lima refineries while 2000 reflected only the planned maintenance turnaround on the crude unit at Port Arthur. Capital expenditures for property, plant and equipment totaled $94.5 million in 2001, $390.7 million in 2000 and $438.2 million in 1999. Expenditures for property, plant and equipment included $19.0 million, $346.0 million, and $387.6 million in 2001, 2000 and 1999, respectively, related to the Port Arthur heavy oil upgrade project. Expenditures for property, plant and equipment related to mandatory capital expenditures were $37.5 million in 2001, $33.2 million in 2000 and $27.7 million in 1999. Expenditures for refinery maintenance turnarounds totaled $49.2 million in 2001, $31.5 million in 2000 and $77.9 million in 1999, with the Lima refinery undergoing its first major turnaround in 1999 since its acquisition in 1998.

The estimates stated above for future capital expenditures do not include capital expenditure estimates for the Memphis refinery. The sellers of the Memphis refinery estimate that capital expenditures for the refinery will be approximately $80 million for compliance with Tier 2 gasoline standards based on an implementation date of the first quarter of 2004, and approximately $100 million for compliance with low sulfur diesel standards. We do not anticipate the need to spend any capital for MACT II compliance at the Memphis refinery. We also estimate that other mandatory and refinery maintenance turnaround expenditures will be approximately $48 million per year over the next four years for the Memphis refinery.

Cash Flow from Financing Activities

Cash flow used in financing activities were $219.8 million for the nine months ended September 30, 2002 compared to $68.8 million in the prior year for the same period. In 2002, we received total net proceeds, or IPO proceeds, of $482.0 million from the sale of our common stock, which consisted of net proceeds of $462.6 million from an initial public offering of 20.7 million shares of our common stock, $19.1 million from the concurrent sales of 850,000 shares of common stock in the aggregate to Mr. O Malley and two of our directors, and $0.3 million from the exercise of stock options under our stock option plans. The proceeds from the initial public offering and concurrent sales are committed to reducing the long-term debt of our subsidiaries, and as of September 30, 2002 we had contributed a net $442.9 million to our subsidiaries for the early repayment of debt.

In 2002, we redeemed and repurchased portions of our long-term debt totaling $645.2 million in aggregate principal amount. In June 2002, we redeemed the remaining $150.4 million of our 9 $^{1}/2$% senior notes at par and the remaining $144.4 million of our 10 $^{7}/8$% senior notes with a $5.2 million premium, all mainly from IPO proceeds.

On April 1, 2002, we exchanged all of our 11 $^{1}/2$% exchangeable preferred stock for 11 $^{1}/2$% subordinated debentures. In 2002, we purchased, in the open market, $57.5 million in aggregate principal amount of our 11 $^{1}/2$% subordinated debentures at a $3.3 million premium from IPO proceeds.

In January 2002, we made a $66.2 million principal payment on our senior secured bank loan with $59.7 million representing a mandatory prepayment pursuant to the common security agreement and secured account structure. In June 2002, we prepaid the remaining balance of $221.4 million on the senior secured bank loan at a $0.9 million premium, with $84.2 million of IPO proceeds and available cash. In the third quarter of 2002, we made a mandatory $4.3 million principal payment on our 12 $^{1}/2$% senior notes.

Cash and cash equivalents restricted for debt service increased by $21.1 million, of which an increase of $45.2 million related to future principal payments is included in cash flow from financing activity and a decrease of $24.1 million related to future interest payments is included in cash flow from operating activities. The

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increase in the amount restricted for principal payments mainly reflected the new requirement under the amended and restated common security agreement to maintain a $45.0 million debt service reserve at all times.

In September 2001, we repurchased in the open market $21.3 million in face value of our 9 1/2% senior notes, $30.6 million in face value of our 10 7/8% senior notes, and $5.9 million in face value of our 11 1/2% exchangeable preferred stock, which on April 1, 2002 were converted into 11 1/2% subordinated debentures, for an aggregate purchase price of $48.5 million. We recorded a gain of $8.7 million related to the repurchase of this debt, which included a discount of $9.3 million and a write-off of associated deferred financing costs of $0.6 million.

In 2002, we incurred deferred financing costs of $11.4 million related to the consent process that permitted the Sabine restructuring, the registration of the 12 1/2% senior notes with the Securities and Exchange Commission following the restructuring, and the waiver related to insurance coverage required under the common security agreement.

Cash flow used in financing activities for the year ended December 31, 2001 were $66.3 million as compared to cash flow provided by financing activities of $234.8 million for the year ended December 31, 2000 and $393.9 million for the year ended December 31, 1999. The cash provided by financing activity in 2000 and 1999 included proceeds from our senior secured bank loan, 12 1/2% senior notes, and shareholder contributions received pursuant to capital contribution agreements that were all used to fund the heavy oil upgrade project. There were no similar proceeds in the year ended December 31, 2001.

We have incurred debt at three different entities within our corporate structure: Premcor USA, PRG, and PAFC. Any movement of funds, assets, or other transactions among our various subsidiaries must comply with all provisions of the debt instruments at each subsidiary in addition to customary limitations on transactions with affiliates. After giving effect to this offering and the debt financing and the use of a portion of the proceeds to refinance certain indebtedness of our subsidiaries, as of September 30, 2002, we are required to make the following principal payments on our long-term debt: $0.7 million in the remainder of 2002; $14.9 million in 2003; $25.6 million in 2004; $38.5 million in 2005; $46.4 million in 2006; $318.4 million in 2007; and $601.9 million in the aggregate thereafter. We continue to evaluate the most efficient use of capital and, from time to time, depending upon market conditions, may seek to purchase certain of our outstanding debt securities in the open market or by other means, in each case to the extent permitted by existing covenant restrictions.

As part of the Sabine restructuring, PACC terminated its Winterthur International Insurance Company Limited oil payment guaranty insurance policy, which had guaranteed Maya crude oil purchase obligations made under our long-term agreement with an affiliate of PEMEX. PACC also terminated its $35 million bank working capital facility, which primarily supported non-Maya crude oil purchase obligations. As such, all PACC crude oil purchase obligations are now supported under an amended PRG working capital facility.

PRG has a credit agreement, which provides for the issuance of letters of credit, primarily for the purchases of crude oil, up to the lesser of $650 million or the amount of a borrowing base calculation. In May 2002, PRG amended its $650 million credit agreement to allow for the PACC crude oil purchase obligations. The borrowing base is calculated with respect to our eligible cash and cash equivalents, investments, receivables, petroleum inventories, paid but unexpired letters of credit, and net obligations on swap contracts. Under the amendment, the borrowing base calculation was amended to include PACC inventory. Also as amended, the $650 million limit can be increased by $50 million at the request of PRG upon securing additional commitments. The credit agreement provides for direct cash borrowings up to $50 million. Borrowings under the credit agreement are secured by a lien on substantially all of PRG s cash and cash equivalents, receivables, crude oil and refined product inventories and trademarks. The borrowing base associated with such facility at September 30, 2002 was $797.1 million with $520.2 million of the facility utilized for letters of credit. As of September 30, 2002, there were no direct cash borrowings under the credit agreement.

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The credit agreement contains covenants and conditions that, among other things, limit our dividends, indebtedness, liens, investments and contingent obligations. We are also required to comply with certain financial covenants, including the maintenance of working capital of at least $150 million, the maintenance of tangible net worth of at least $400 million, as amended, and the maintenance of minimum levels of balance sheet cash (as defined therein) of $75 million at all times. The covenants also provide for a cumulative cash flow test that from July 1, 2001 must not be less than zero. In March 2002, we received a waiver regarding the maintenance of the tangible net worth covenant, which allows for the exclusion of $120 million for the pretax restructuring charge related to the closure of the Hartford refinery.

We must amend this credit agreement to extend the maturity date from August 23, 2003 to three years from the closing of the amendment and obtain various waivers and approvals under this credit agreement in order to consummate the debt financing and the acquisition of the Memphis refinery. In addition, we are seeking to amend and restate this credit agreement to, among other things, increase the capacity under the agreement from $650 million to the lesser of $750 million or the amount available under the borrowing base; and increase the sub-limit for cash borrowings from $50 million to $200 million, subject to certain restrictions. Certain covenants relating to minimum cash requirements, permitted indebtedness and minimum net worth requirements will also be modified. There are no assurances that we will be able to obtain the necessary extension, waivers and approvals or enter into an amended and restated credit agreement on these terms or at all.

Our long-term debt instruments subject us to significant financial and other restrictive covenants. Covenants contained in various indentures, credit agreements, and term loan agreements place restrictions on, among other things, our subsidiaries ability to incur additional indebtedness, place liens upon our subsidiaries assets, pay dividends or make certain other restricted payments and investments. Some debt instruments also require our subsidiaries to satisfy or maintain certain financial condition tests.

Funds generated from operating activities together with existing cash, cash equivalents and short-term investments and proceeds from asset sales are expected to be adequate to fund existing requirements for working capital and capital expenditure programs for the next year. Due to the commodity nature of our products, our operating results are subject to rapid and wide fluctuations. While we believe that our operating philosophies will be sufficient to provide us with adequate liquidity through the next year, there can be no assurance that market conditions will not be worse than anticipated. Future working capital, discretionary capital expenditures, environmentally mandated spending and acquisitions may require additional debt or equity capital.

Accounting Standards

Critical Accounting Standards

Contingencies. We account for contingencies in accordance with the Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5 (SFAS No.5), *Accounting for Contingencies*. SFAS No. 5 requires that we record an estimated loss from a loss contingency when information available prior to the issuance of our financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Accounting for contingencies such as environmental, legal and income tax matters require us to use our judgment. While we believe that our accruals for these matters are adequate, if the actual loss from a loss contingency is significantly different than the estimated loss, our results of operations may be over or understated.

Major Maintenance Turnarounds. The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants, or AcSEC, had issued an exposure draft of a proposed statement of position, or SOP, entitled *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. If adopted as proposed, this SOP would have, among other things, required companies to expense as incurred turnaround costs, which it terms as the non-capital portion of major maintenance costs. Adoption of the proposed SOP would have also required that any existing unamortized turnaround costs be expensed

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immediately. As of September 30, 2002, we had approximately $97 million in unamortized turnaround costs on our balance sheet. A turnaround is a periodically required standard procedure for maintenance of a refinery that involves the shutdown and inspection of major processing units and generally occurs every three to five years. Turnaround costs include actual direct and contract labor, and material costs for the overhaul, inspection, and replacement of major components of refinery processing and support units performed during the turnaround. We currently amortize turnaround costs, which are included in our consolidated balance sheets in Other Assets, on a straight-line basis over the period until the next scheduled turnaround, beginning the month following completion. The amortization of turnaround costs is presented as Amortization on our consolidated statements of operations.

In December 2002, AcSEC discontinued discussions concerning this SOP and handed over the responsibility for any further action to the FASB. The FASB stated that it might add the issues related to this SOP to its agenda, but it would be at least 12 months until any consideration is made. At its January 2003 meeting, AcSEC agreed to meet with the FASB to discuss the possibility of adopting a shortened version of the original exposure draft that would address major maintenance costs or turnaround costs. Whether there will be new accounting guidance and when it would become effective is currently unclear.

Impairment of Long-Lived Assets. In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of*, and the accounting and reporting provisions of Accounting Principles Board Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business (as previously defined in that Opinion). The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, with early application encouraged. The implementation of SFAS 144 did not have a material impact on our financial position or results of operations.

Inventories. Inventories for our company are stated at the lower of cost or market. As of January 1, 2002, cost is determined under the LIFO method for hydrocarbon inventories including crude oil, refined products, and blendstocks. Prior to this date the cost of Sabine s hydrocarbon inventories was determined under the first-in, first-out, or FIFO, method. The cost of warehouse stock and other non-hydrocarbon inventories is determined under the FIFO method. Any reserve for inventory cost in excess of market value is reversed if physical inventories turn and prices recover above cost. At December 31, 2001 the replacement cost (market value) of our crude oil and refined product inventories exceeded its carrying value by $4.9 million. We had 15.4 million barrels of crude oil and refined product inventories at December 31, 2001 with an average cost of $19.09 per barrel. If the market value of these inventories had been lower by $1 per barrel at December 31, 2001, we would have been required to write-down the value of our inventory by $10.5 million. If prices decline from year-end 2001 levels, we may be required to write-down the value of our inventories in future periods.

New Accounting Standards

On January 1, 2002, we adopted Statement of Financial Accounting Standard, or SFAS, No. 142, *Goodwill and Other Intangible Assets,* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The adoption of these standards did not have a material impact on our financial position and results of operations; however, SFAS No. 144 was utilized in the accounting for our announced intention to discontinue refining operations at the Hartford, Illinois refinery.

In July 2001, the Financial Accounting Standards Board, or FASB, approved SFAS No. 143, *Accounting for Asset Retirement Obligations.* SFAS No. 143 addresses when a liability should be recorded for asset retirement obligations and how to measure this liability. The initial recording of a liability for an asset retirement obligation will require the recording of a corresponding asset that will be required to be amortized. SFAS No. 143 is

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effective for fiscal years beginning after June 15, 2002. We are in the process of evaluating the impact of the adoption of this standard on our financial position and results of operations and believe implementation will not have a material impact.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections*. SFAS 145 rescinds SFAS No. 4, *Reporting Gains and Losses from the Extinguishment of Debt*; SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*; and SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*. SFAS No. 145 also amends SFAS No. 13, *Accounting for Leases*, as it relates to sale-leaseback transactions and other transactions structured similar to a sale-leaseback as well as amends other pronouncements to make various technical corrections. The provisions of SFAS No. 145 as they relate to the rescission of SFAS No. 4 shall be applied in fiscal years beginning after May 15, 2002. The provision of this statement related to the amendment to SFAS No. 13 shall be effective for transactions occurring after May 15, 2002. All other provisions of this statement shall be effective for financial statements on or after May 15, 2002. As permitted by the statement, we have elected early adoption of SFAS 145 and, accordingly, have included any gains or losses on extinguishment of debt in Income from continuing operations as opposed to as an extraordinary item, net of taxes, below Income from continuing operations in our Statement of Operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires the recognition of liabilities at fair value that are associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such liabilities include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing or other exit or disposal activities. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. We will adopt SFAS No. 146 for all restructuring, discontinued operations, plant closings or other exit or disposal activities initiated after December 31, 2002.

Quantitative and Qualitative Disclosures About Market Risk

The risk inherent in our market risk sensitive instruments and positions is the potential loss from adverse changes in commodity prices and interest rates. None of our market risk sensitive instruments is held for trading.

Commodity Risk

Our earnings, cash flow and liquidity are significantly affected by a variety of factors beyond our control, including the supply of, and demand for, commodities such as crude oil, gasoline and other refined products. The demand for these refined products depends on, among other factors, changes in domestic and foreign economies, weather conditions, domestic and foreign political affairs, planned and unplanned downtime in refineries, pipelines and production facilities, production levels, the availability of imports, the marketing of competitive fuels and the extent of government regulation. As a result, crude oil and refined product prices fluctuate significantly, which directly impacts our net sales and operating revenues and costs of goods sold.

The movement in petroleum prices does not necessarily have a direct long-term relationship to net income. The effect of changes in crude oil prices on our operating results is determined more by the rate at which the prices of refined products adjust to reflect such changes. We are required to fix the price on our crude oil purchases approximately two to three weeks prior to the time when the crude oil can be processed and sold. As a result, we are exposed to crude oil price movements relative to refined product price movements during this period. In addition, earnings may be impacted by the write-down of our inventory cost to market value when market prices drop dramatically compared to our inventory cost. These potential write-downs may be recovered in subsequent periods as our inventories turn and market prices rise. If prices decline dramatically near the end of a period, we may be required to write-down the value of our inventories in future periods. In 1997 and 1998 the

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market value of our petroleum inventory was below original cost, which resulted in a write-down of inventory to fair market value. The write-down was fully recovered in 1999 when market values increased. Earnings may continue to be impacted by these write-downs, or recovery of write-downs, to market value.

As of December 31, 2001, we had 15.4 million barrels of crude oil and refined product inventories. We had 12.6 million barrels of crude oil and refined product inventories that were valued under the LIFO inventory method with an average cost of $20.32 per barrel. As of December 31, 2001, the replacement cost (market value) of this inventory exceeded its carrying value by $4.9 million. If the market value of these inventories had been lower by $1 per barrel as of December 31, 2001, we would have been required to write-down the value of our inventory by $7.7 million. We had 2.8 million barrels of crude oil and refined product inventories that were valued under the first-in, first-out, or FIFO, inventory method with an average cost of $13.58 per barrel. The carrying value of this inventory approximated replacement cost (market value). If the market value of these inventories had been lower by $1 per barrel we would have been required to write-down the value of our inventory by $2.8 million.

As of December 31, 2000, we had 18.0 million barrels of crude oil and refined product inventories. We had 15.6 million barrels of crude oil and refined product inventories that were valued under the LIFO inventory method with an average cost of $19.94 per barrel. The replacement cost (market value) of this inventory exceeded its carrying value by $100.8 million. If the market value of these inventories had been lower by $1 per barrel as of December 31, 2000, we would not have been required to write-down the value of our inventory and would not have had to record a write-down unless market was lower by over $7 per barrel. We had 2.4 million barrels of crude oil and refined product inventories that were valued under the FIFO inventory method with an average cost of $18.38 per barrel. If the market value of these inventories had been lower by $1 per barrel we would have been required to write-down the value of our inventory by $2.4 million.

As of January 1, 2002, all of our hydrocarbon inventories were valued using the LIFO method. Our inventories that are valued under the LIFO method are more susceptible to a material write-down when prices decline dramatically. If prices decline from year-end 2001 levels, we may be required to write-down the value of our LIFO inventories in future periods.

The nature of our business leads us to maintain a substantial investment in petroleum inventories. Since petroleum feedstocks and products are essentially commodities, we have no control over the changing market value of our investment. We manage the impact of commodity price volatility on our hydrocarbon inventory position by, among other methods, determining a volumetric exposure level that we consider appropriate and consistent with normal business operations. This target inventory position includes both titled inventory and fixed price purchase and sale commitments. The portion of our current target inventory position consisting of sales commitments netted against fixed price purchase commitments amounts to a net long inventory position of approximately 4 million barrels.

Prior to the second quarter of 2002, we did not generally price protect any portion of our target inventory position. However, although we continue to generally leave the titled portion of our inventory position target fully exposed to price fluctuations, beginning in the second quarter of 2002, we began to actively mitigate some or all of the price risk related to our target level of fixed price purchase and sale commitments. These risk management decisions are based on the relative level of absolute hydrocarbon prices. The cumulative economic effect of our risk management strategy in the second and third quarter of 2002 resulted in an approximate $11 million loss as measured against a fully exposed fixed price commitment target. In the first quarter of 2002, we benefited by approximately $30 million from having our fixed price commitment target fully exposed in a rising absolute price environment.

We use several strategies to minimize the impact on profitability of volatility in feedstock costs and refined product prices. These strategies generally involve the purchase and sale of exchange-traded, energy-related futures and options with a duration of six months or less. To a lesser extent we use energy swap agreements

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similar to those traded on the exchanges, such as crack spreads and crude oil options, to better match the specific price movements in our markets as opposed to the delivery point of the exchange-traded contract. These strategies are designed to minimize, on a short-term basis, our exposure to the risk of fluctuations in crude oil prices and refined product margins. The number of barrels of crude oil and refined products covered by such contracts varies from time to time. Such purchases and sales are closely managed and subject to internally established risk standards. The results of these price risk mitigation activities affect refining cost of sales and inventory costs. We do not engage in speculative futures or derivative transactions.

We prepared a sensitivity analysis to estimate our exposure to market risk associated with derivative commodity positions. This analysis may differ from actual results. The fair value of each derivative commodity position was based on quoted futures prices. As of September 30, 2002, a 10% change in quoted futures prices would result in an $8.8 million change to the fair market value of the derivative commodity position and correspondingly the same change in operating income. As of December 31, 2001, a 10% change in quoted futures prices would result in an $8.1 million change to the fair market value of the derivative commodity position and correspondingly the same change in operating income.

Interest Rate Risk

During 2002, as of September 30, we repaid $645.2 million of our long-term debt, leaving an outstanding balance, including current maturities, of $925.3 million at September 30, 2002. Our primary interest rate risk is associated with our long-term debt. We manage this interest rate risk by maintaining a high percentage of our long-term debt with fixed rates. The weighted average interest rate on our fixed rate long-term debt is slightly over 10%. We are subject to interest rate risk on our floating rate loans and any direct borrowings under our credit facility. As of September 30, 2002, a 1% change in interest rates on our floating rate loans, which totaled $250 million, would result in a $2.5 million change in pretax income on an annual basis. As of December 31, 2001, a 1% change in interest rate on our floating rate loans, which totaled $538 million, would result in a $5.4 million change in pretax income on an annual basis. As of September 30, 2002 and December 31, 2001, there were no borrowings under our credit agreement.

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INDUSTRY OVERVIEW

Oil refining is the process of separating hydrocarbon atoms present in crude oil and converting them into usable finished petroleum products. There are approximately 150 oil refineries operating in the United States. The refining industry is characterized by capacity shortage, high utilization, and reliance on imported products to meet demand for finished petroleum products. This overview explains the basics of the refining process and certain factors that influence our industry.

Refining Basics

Refineries are uniquely designed to process specific crude oils into selected products. In general, the different process units inside a refinery perform one of three functions:

- separate the many types of hydrocarbons present in crude oil;
- chemically convert the separated hydrocarbons into more desirable products; and
- treat the products by removing unwanted elements and compounds.

Each step in the refining process is designed to maximize the value of the feedstocks, particularly the raw crude oil.

The first refinery units to process raw crude oil are typically the atmospheric and vacuum distillation units. Crude oil is separated by boiling point in the distillation units under high heat and low pressure and recovered as hydrocarbon fractions. The lowest boiling fractions, including gasoline and liquefied petroleum gas, vaporize and exit the top of the atmospheric distillation unit. Medium boiling liquids, including jet fuel, kerosene and distillates such as home heating oil and diesel fuel, are drawn from the middle. Higher boiling liquids, called gas oils and the highest boiling liquids, called residuum, are drawn together from the bottom and separated in the vacuum distillation unit. The various fractions are then pumped to the next appropriate unit in the refinery for further processing into higher-value products.

The next step in the refining process is to convert the hydrocarbon fractions into distinct products. One of the ways of accomplishing this is through cracking, a process that breaks or cracks higher boiling fractions into more valuable products such as gasoline, distillate and gas oil. The most important conversion units are the coker, the FCC unit, and the hydrocracker. Thermal cracking is accomplished in the coker, which upgrades residuum into naphtha, which is a low-octane gasoline fraction, distillate, and gas oil. The FCC unit converts gas oil from the crude distillation units and coker into liquefied petroleum gas, gasoline, and distillate by applying heat in the presence of a catalyst. The hydrocracker receives feedstocks from the coker, FCC and crude distillation units. This unit converts lower value intermediate products into gasoline, naphtha, kerosene, and distillates under very high pressure in the presence of hydrogen and a catalyst.

Finally, the intermediate products from the distillation and conversion processes are treated to remove impurities such as sulfur, nitrogen and heavy metals, and are processed to enhance octane, reduce vapor pressure, and meet other product specifications. Treatment is accomplished in hydrotreating units by heating the intermediates under high pressure in the presence of hydrogen and catalysts. Octane enhancement is accomplished primarily in a reformer. The reformer converts naphtha, or low-octane gasoline fractions, into higher octane gasoline blendstocks used in increasing the overall octane level of the gasoline pool. Vapor pressure reduction is accomplished primarily in an alkylation unit. The alkylation unit decreases the vapor pressure of gasoline blendstocks produced by the FCC and coker units through the conversion of light olefins to heavier, high-octane paraffins.

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Refinery Products

Major refinery products include:

Gasoline. The most significant refinery product is motor gasoline. Various gasoline blendstocks are blended to achieve specifications for regular and premium grades in both summer and winter gasoline formulations. Refiners must also produce many grades of reformulated gasoline. Reformulated gasolines are special blends containing oxygenates, such as ethers or alcohols, that are tailored to areas of the country with severe ozone pollution. Additives are often used to enhance performance and provide protection against oxidation and rust formation.

Distillate Fuels. Distillates are diesel fuels and domestic heating oils.

Kerosene. Kerosene is a refined middle-distillate petroleum product that is used for jet fuel, cooking and space heating, lighting, solvents and for blending into diesel fuel.

Petrochemicals. Many products derived from crude oil refining, such as ethylene, propylene, butylene and isobutylene, are primarily intended for use as petrochemical feedstock in the production of plastics, synthetic fibers, synthetic rubbers and other products. A variety of products are produced for use as solvents, including benzene, toluene and xylene.

Liquefied Petroleum Gas. Liquefied petroleum gases, consisting primarily of propane and butane, are produced for use as a fuel and an intermediate material in the manufacture of petrochemicals.

Residual Fuels. Many marine vessels, power plants, commercial buildings and industrial facilities use residual fuels or combinations of residual and distillate fuels for heating and processing. Asphalts are also made from residual fuels and are used primarily for roads and roofing materials.

Petroleum Coke. Petroleum coke, a by-product of the coking process, is almost pure carbon and has a variety of uses. Fuel grade coke is used primarily by power plants as fuel for producing electricity. Premium grades of coke low in sulfur and metal content are used as anodes for the manufacture of aluminum.

Crude Oil

The quality of crude oil dictates the level of processing and conversion necessary to achieve the optimal mix of finished products. Crude oils are classified by their density (light to heavy) and sulfur content (sweet to sour). Light sweet crude oils are more expensive than heavy sour crude oils because they require less treatment and produce a slate of products with a greater percentage of high-priced, light, refined products such as gasoline, kerosene and jet fuel. The heavy sour crude oils typically sell at a discount to the lighter, sweet crude oils because they produce a greater percentage of lower-value products with simple distillation and require additional processing to produce the higher-value light products. Consequently, refiners strive to process the optimal mix, or slate, of crude oils through their refineries, depending on each refinery s conversion and treating equipment, the desired product output, and the relative price of available crude oils.

Refinery Complexity

Refinery complexity refers to a refinery s ability to process less-expensive feedstock, such as heavier and higher-sulfur content crude oils, into value-added products. Generally, the higher the complexity and more flexible the feedstock slate, the better positioned the refinery is to take advantage of the more cost-effective crude oils, resulting in incremental gross margin opportunities for the refinery.

Refinery Locations

A refinery s location can have an important impact on its refining margins since a refinery s location can influence its ability to access feedstocks and distribute its products efficiently. There are five regions in the

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United States, as defined by the Petroleum Administration for Defense Districts, or PADDs, that have historically experienced varying levels of refining profitability due to regional market conditions. For example, refiners located in the Gulf Coast operate in a highly competitive market due to the fact that this region (PADD III) accounts for approximately 37% of the total number of United States refineries and approximately 46% of the country s refining capacity. Alternatively, demand for gasoline and distillates has historically exceeded refining production by approximately 35% in the Midwest (PADD II). PADD I represents the East Coast, PADD IV the Rocky Mountains and PADD V is the West Coast.

Structure of Refining Companies

Refiners typically are structured as part of an integrated oil company or as an independent entity. Integrated oil companies have upstream operations, which are concerned with the exploration and production of crude oil, combined with downstream, or refining, operations. An independent refiner has no source of proprietary crude oil production.

Refiners primarily distribute their products as either wholesalers or retailers. Refiners who operate as wholesalers principally sell their refined products under spot and term contracts to bulk and truck rack customers. Wholesalers who sell their products on an unbranded basis are called merchant refiners. Many refiners, both integrated and independent, distribute their refined products through their own retail outlets.

Economics of Refining

Refining is primarily a margin-based business where both the feedstocks and refined finished products are commodities. Because operating expenses are relatively fixed, the refiners goal is to maximize the yields of high-value products and to minimize feedstock costs.

The industry uses a number of benchmarks to measure market values and margins:

West Texas Intermediate. In the United States, West Texas Intermediate crude oil is the reference quality crude oil. West Texas Intermediate is a light sweet crude oil and the West Texas Intermediate benchmark is used in both the spot and futures markets.

3/2/1 crack spread. Crack spreads are a proxy for refining margins and refer to the margin that would accrue from the simultaneous purchase of crude oil and the sale of refined petroleum products, in each case at the then prevailing price. The 3/2/1 crack spread assumes three barrels of West Texas Intermediate crude oil will produce two barrels of regular unleaded gasoline and one barrel of high-sulfur diesel fuel. Average 3/2/1 crack spreads vary from region to region depending on the supply and demand balances of crude oils and refined products.

Actual refinery margins vary from the 3/2/1 crack spread due to the actual crude oil used and products produced, transportation costs, regional differences, and the timing of the purchase of the feedstock and sale of the light products.

High complexity refineries are able to utilize crude oils lower in cost than West Texas Intermediate. The economic advantage of these refineries is estimated by using the heavy/light and the sweet/sour differentials.

Heavy/light differential. The heavy/light differential is the price differential between Maya, a heavy, sour crude oil, and West Texas Intermediate crude oil. Maya crude oil typically trades at a discount to West Texas Intermediate crude oil.

Sweet/sour differential. The sweet/sour differential is the price differential between West Texas Sour, a medium sour crude oil and West Texas Intermediate crude oil. West Texas Sour crude oil trades at a discount to West Texas Intermediate crude oil. Typically, the sweet/sour differential is less than the heavy/light differential.

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Product differentials. Because refineries produce many other products that are not reflected in the crack spread, product differentials to regular unleaded gasoline and high-sulfur diesel are calculated to analyze the product mix advantage of a given refinery. Those refineries that produce relatively high volumes of premium products such as premium and reformulated gasoline, low-sulfur diesel fuel and jet fuel and relatively low volumes of by-products such as liquefied petroleum gas, residual fuel oil, petroleum coke, and sulfur have an economic advantage.

Operating expenses. Major operating costs include employee labor, repairs and maintenance, and energy. Employee labor and repairs and maintenance are relatively fixed costs that generally increase proportional to inflation. By far, the predominant variable cost is energy and the most reliable price indicator for energy costs is the cost of natural gas.

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BUSINESS

Overview

We are one of the largest independent petroleum refiners and suppliers of unbranded transportation fuels, heating oil, petrochemical feedstocks, petroleum coke and other petroleum products in the United States. We currently own and operate two refineries in Port Arthur, Texas and Lima, Ohio with a combined crude oil throughput capacity of approximately 420,000 bpd. In late September 2002, we ceased refining operations at our Hartford, Illinois refinery and are currently pursuing all strategic options, including expanding the uses of the petroleum product and distribution facility and selling or leasing the refinery, to mitigate the loss of jobs and refinery capacity in the Midwest. We continue to operate the terminal facility at the Hartford refinery to accommodate our wholesale petroleum product distribution business. We sell petroleum products in the Midwest, the Gulf Coast, eastern and southeastern United States. We sell our products on an unbranded basis to approximately 750 distributors and chain retailers through our own product distribution system and an extensive third-party owned product distribution system, as well as in the spot market.

For the nine months ended September 30, 2002, light products accounted for approximately 90% of our total product volume. For the same period, high-value, premium product grades, such as high octane and reformulated gasoline, low-sulfur diesel and jet fuel, which are the most valuable types of light products, accounted for approximately 40% of our total product volume.

We source our crude oil on a global basis through a combination of long-term crude oil purchase contracts, short-term purchase contracts and spot market purchases. The long-term contracts provide us with a steady supply of crude oil, while the short-term contracts and spot market purchases give us flexibility in obtaining crude oil. Since all of our refineries have access, either directly or through pipeline connections, to deepwater terminals, we have the flexibility to purchase foreign crude oils via waterborne delivery or domestic crude oils via pipeline delivery. Our Port Arthur refinery, which possesses one of the world s largest coking units, can process 80% heavy sour crude oil. Approximately 80% of the crude oil supply to our Port Arthur refinery is lower cost heavy sour crude oil from Mexico, called Maya, most of which benefits from a mechanism intended to provide us with a minimum average coker gross margin and moderate fluctuations in coker gross margins during an eight-year period beginning on April 1, 2001.

Recent Developments

Memphis Refinery Acquisition

On November 25, 2002, we announced that we had executed a definitive agreement with The Williams Companies, Inc. and certain of its subsidiaries to purchase their Memphis, Tennessee refinery and related supply and distribution assets. The purchase price for the refinery and the other assets is $315 million plus the value of inventories at closing, which were estimated to be $150 million at the time of the agreement. The agreement also provides for contingent participation, or earn-out, payments that could result in additional payments of up to $75 million by us to Williams over the next seven years, depending on the level of industry refining margins during that period.

The Memphis refinery has a rated crude oil throughput capacity of 190,000 bpd but typically processes approximately 170,000 bpd. The related assets include two truck-loading racks; three petroleum terminals in the area; supporting pipeline infrastructure that transports both crude oil and refined products; crude oil tankage at St. James, Louisiana; and an 80 megawatt power plant adjacent to the refinery.

We believe that we are acquiring a quality refinery at an attractive price that will produce operating and economic synergies and that should be accretive to our earnings per share and generate positive cash flow from operations. Completion of the acquisition is subject to our obtaining the requisite financing and the satisfaction of customary conditions, including regulatory approvals. We intend to finance the acquisition from the proceeds of this offering and the other financing transactions. We expect the acquisition to close during the first quarter of 2003.

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Our Predecessors and Corporate Structure

Clark USA, Inc., our predecessor, was formed by TrizecHahn Corporation, or TrizecHahn, in 1988 to acquire a controlling interest in certain refining, distribution and marketing assets from the bankruptcy estate of Clark Oil & Refining Corporation. Those assets, which included the Hartford refinery, a Blue Island, Illinois refinery and certain Clark USA retail operations and product terminals, were acquired by Clark Refining & Marketing, Inc., a wholly owned subsidiary of Clark USA. In November 1997, Blackstone acquired a majority interest in Clark USA from TrizecHahn. In 1999, we were formed as Clark Refining Holdings, Inc., a holding company for 100% of the capital stock of Clark USA. In 2000, we changed our name to Premcor Inc., Clark USA changed its name to Premcor USA Inc. and Clark Refining & Marketing, Inc., one of our operating subsidiaries, changed its name to The Premcor Refining Group Inc.

In 1999, in connection with the financing of the heavy oil upgrade project at our Port Arthur refinery, we acquired 90% of the capital stock of Sabine River Holding Corp., a new entity formed to be the general partner of PACC, the entity created to own and lease the assets comprising the heavy oil processing facility. Sabine also owns 100% of the capital stock of Neches River Holding Corp., which was formed to be the 99% limited partner of PACC. PACC entered into product purchase, service and supply agreements and facility, site and ground leases, and other arm s length arrangements with PRG as part of the heavy oil upgrade project.

In connection with the Sabine restructuring, on June 6, 2002, we consummated a share exchange with Occidental Petroleum Corporation whereby we received the remaining 10% of the common stock of Sabine. For a discussion of our relationship with Occidental, see Related Party Transactions Our Relationship with Occidental. Upon consummation of the share exchange with Occidental, we contributed our ownership interest in Sabine to PRG and Sabine became a direct, wholly owned subsidiary of PRG.

The following chart summarizes the current corporate structure of Premcor Inc. and its affiliates as a result of the Sabine restructuring:

The Transformation of Premcor

Beginning in early 1995 and continuing after Blackstone acquired its controlling interest in our predecessor in 1997, we completed several strategic initiatives that have significantly enhanced our competitive position, the quality of our assets, and our financial and operating performance. The following statements regarding our transformation exclude our Hartford refinery at which we ceased refining operations in late September 2002. For example, we:

Divested our Non-core Assets to Focus on Refining. We divested our non-core assets during 1998 and 1999, generating net proceeds of approximately $325 million, which we reinvested into our refining business. In 1998, we sold minority interests in several crude oil and product pipelines. In July 1999, we sold our retail business, which included 672 company-operated, and over 200 franchised, gas convenience stores. Also in 1999, we sold the majority of our product distribution terminals.

Acquired Additional Competitive Refining Capacity. We increased our net crude oil throughput capacity from approximately 130,000 bpd to 420,000 bpd after closing two refineries by acquiring our Lima and Port Arthur refineries and subsequently upgrading our Port Arthur refinery. In 1995, we significantly changed the character of our asset base by acquiring the Port Arthur refinery, which was then operating at a capacity of 178,000 bpd. In August 1998, we further expanded our refining capacity by acquiring the 170,000 bpd Lima refinery.

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Invested in Improving the Productivity of our Asset Base. We implemented capital projects to increase throughput and premium product yields and to reduce operating expenses within our refining asset base. Upon the acquisition of our Port Arthur refinery in 1995, we initially upgraded the facility to a capacity of 232,000 bpd. In January 2001, we completed construction and commenced operation of a heavy oil upgrade project at Port Arthur, further increasing its capacity to 250,000 bpd and significantly expanding its ability to process heavy sour crude oil. Since the acquisition of the Lima refinery in 1998, we have improved the product distribution logistics surrounding the refinery to allow the refinery to increase its throughput and more fully utilize that facility s 170,000 bpd capacity. We allocate capital to these projects based on a rigorous analysis of the expected return on capital. Based upon such a review of our 80,000 bpd Blue Island, Illinois refinery, we determined that, due to its poor competitive position as a relatively small refinery configured to process primarily light sweet crude oil, it would not have been able to meet our return on capital and free cash flow targets. As a result, we closed the Blue Island refinery in January 2001. In September 2002, we ceased refining operations at our Hartford refinery for the same reasons. The Hartford refinery would not have been able to meet our return on capital and free cash flow targets due to its relatively small size and the amount of investment necessary to meet new federally mandated fuel specifications. These productivity improvements, together with the acquisitions of our Port Arthur and Lima refineries, and the closure of non-competitive capacity strengthened our asset base, increased our coking capacity from 18,000 bpd to 113,000 bpd, increased our cracking capacity from 70,000 bpd to 178,000 bpd and increased our capacity to process sour and heavy sour crude oil from 45,000 bpd in 1994 to 200,000 bpd, an approximate 340% increase.

Improved our Operations and Safety Performance. We have implemented a number of programs which increased the reliability of our operations and improved our safety performance resulting in a reduction of our recordable injury rate from 3.12 to 1.14 per 200,000 hours worked. In 2001, we appointed a director of reliability, established an internal benchmarking and best practices program, developed a root-cause analysis program and installed an automated maintenance management system. Over the last several years, we made significant expenditures to improve our safety record. As a result, we have significantly reduced our company-wide recordable injuries and lost time injuries, each as defined by the Occupational Safety and Health Administration, or OSHA. We reduced our recordable injury rate by approximately 60% from 1995 to September 2002. From our acquisition of the Lima refinery in July 1998 through the end of 2001 the refinery accumulated over approximately three million employee hours without a lost time injury. From August 1997 through the third quarter of 2001, our Port Arthur refinery accumulated over seven million employee hours without a lost time injury. The streak ended on October 4, 2001 when our Port Arthur refinery incurred its first lost time injury in over four years. According to a survey by the National Petrochemical & Refiners Association, or NPRA, which was conducted for year-end 1999, of the approximately 218 United States refining and chemical facilities included in the survey, only five such facilities had ever achieved the five million employee hour milestone.

Expanded our Unbranded Petroleum Product Distribution Capabilities. We expanded and enhanced our capabilities to supply fuels on an unbranded basis to include the Midwest, Gulf Coast, southeastern and eastern United States. As part of the sale of our terminal operations, we gained access, subject to availability, to an extensive pipeline and terminal network for the distribution of products from each of our refineries.

Reduced Operating Costs. We reduced our operating costs as evidenced by a reduction of our refining employees per thousand barrels from 7.2 to 3.4.

In February 2002, we recruited a new chairman and chief executive officer, Thomas D. O Malley, the former chairman and chief executive officer of Tosco Corporation and former vice chairman and director of Phillips Petroleum Corporation. Mr. O Malley has over 25 years of industry experience and a proven track record of successfully operating, growing and enhancing shareholder value. Since then, we have improved our competitive position as a result of the following:

Recruited and Developed an Experienced Management Team. Mr. O Malley has assembled an executive management team, consisting of Henry M. Kuchta, president and chief operating officer, who joined us in

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April 2002, William E. Hantke, executive vice president and chief financial officer, who joined us in February 2002, Joseph D. Watson, who joined us in March 2002 as senior vice president and chief administrative officer and currently serves as our senior vice president corporate development, and Michael D. Gayda as senior vice president, general counsel and secretary, who joined us in October 2002. These executive officers have an average of almost twenty years experience in the energy and refining industry. In addition, our operational management team has an average of 26 years of energy industry experience.

Completed our IPO. On May 3, 2002, we completed an initial public offering of 20.7 million shares of common stock. The initial public offering, plus the concurrent purchases of 850,000 shares in the aggregate by Thomas D. O Malley and two of our independent directors, netted proceeds to us of approximately $482 million. The proceeds from the offering were committed to retire certain indebtedness of our subsidiaries.

Completed our Sabine Restructuring. On June 6, 2002, we completed a series of transactions, referred to herein as the Sabine restructuring, that resulted in, among other things, all the senior secured debt of Sabine and its subsidiaries, other than the 12 $^{1}/2$% senior secured notes, being paid in full, all commitments under the working capital facility and certain insurance policies being terminated and Sabine and its subsidiaries becoming wholly owned subsidiaries of PRG. In connection with the Sabine restructuring, PRG fully and unconditionally guaranteed, on a senior unsecured basis, the payment obligations under the notes. The Sabine restructuring was permitted by the successful consent solicitation of holders of the notes.

Closed our Hartford, Illinois Refinery. In late September 2002, we ceased refining operations at our Hartford refinery after concluding there was no economically viable method of reconfiguring the refinery to produce fuels meeting new gasoline and diesel fuel specifications mandated by the federal government. Despite ceasing operations, we continue to pursue all strategic options to mitigate the loss of jobs and refinery capacity in the Midwest.

Pending Acquisition of the Memphis Refinery. We entered into an agreement in November 2002 with The Williams Companies, Inc. and certain of its subsidiaries to purchase their Memphis, Tennessee refinery and related supply and distribution assets.

Actions to Reduce Operating and General and Administrative Costs. We have taken and, are continuing to take, steps to reduce our operating and general and administrative costs, including:

- reducing our St. Louis-based administrative workforce by 107 positions, or approximately one-third of the total St. Louis administrative workforce in April 2002;
- announcing our intention to eliminate additional administrative positions by the end of the first quarter of 2003;
- eliminating approximately 80 of our non-represented refinery positions in October 2002; and
- entering into a new crude oil supply agreement for our Lima refinery in October 2002 that we believe will reduce our crude acquisition costs for Lima by roughly 20 cents per barrel.

Market Trends

We believe that the outlook for the United States refining industry is attractive due to the following trends:

Favorable Supply and Demand Fundamentals. We believe that the supply and demand fundamentals for refined petroleum products have improved since the late 1990s and will continue to improve. Decreasing petroleum product demand and deregulation of the domestic refining industry in the 1980s, along with new fuel standards introduced in the early 1990s, contributed to years of decreasing domestic refining capacity. According to the Department of Energy s Energy Information Administration, or EIA, and the Oil and Gas Journal s 2001 Worldwide Refinery Survey, the number of United States refineries has decreased from a peak of 324 in 1981 to

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143 in January 2002. The EIA projects that capacity additions at existing refineries will increase total domestic refining capacity at an annual rate of only 0.5% per year over the next two decades and that utilization will remain high relative to historic levels, ranging from 91% to 95% of design capacity. We believe that impending regulatory requirements will result in the rationalization of non-competitive refineries, further reducing refining supply.

Net imports of petroleum products, largely from northwest Europe and Asia, have historically supplemented domestic refining supply shortfalls, accounting for a relatively consistent amount of approximately 7% of total United States supply over the last 15 years. We expect that imports will continue to occur primarily during periods when refined product prices in the United States are materially higher than in Europe and Asia.

While refining capacity growth is expected by the EIA to be nominal, the EIA expects demand for petroleum products to continue to grow steadily at 1.3% per year over the next two decades. Almost 96% of the projected growth is expected to come from the increased consumption of light products including gasoline, diesel, jet fuel and liquefied petroleum gas.

Increasing Supplies of Lower Cost Sour and Heavy Sour Crude Oil. We believe that increasing worldwide supplies of lower-cost sour and heavy sour crude oil will provide an increasing cost advantage to those refineries with complex configurations that are able to process these crude oils. Purvin & Gertz, an independent engineering firm, estimates that the total worldwide heavy sour crude oil production will increase by approximately 39% from 9.7 million bpd in 2000 to 13.5 million bpd in 2010, resulting in a continuation of the downward price pressure on these crude oils relative to benchmark West Texas Intermediate crude oil. Over the next several years, significant volumes of sour and heavy sour crude oils are expected to be imported into the United States, primarily from Latin America and Canada. Purvin & Gertz expects domestic imports of this production to increase from 3.0 million bpd presently to 5.3 million bpd by 2010.

Increasing Demand for Specialized Refined Petroleum Products. We expect that products meeting new and evolving fuel specifications will account for an increasing share of total fuel demand, which may benefit refiners possessing the capabilities to blend and process these fuels. As part of the Clean Air Act of 1990 and subsequent amendments, several major metropolitan areas in the United States with air pollution problems are required to use reformulated gasoline meeting certain environmental standards. According to the EIA, demand for reformulated gasoline and the oxygenates used in its production will increase from approximately 3.3 million bpd in 2000 to approximately 4 million bpd in 2010, accounting for approximately 40% of all annual gasoline sales. According to officials of the United States Department of Energy, the trend toward banning MTBE as a blendstock in reformulated gasoline will result in an annual reduction of the gasoline supply by 3% to 4%.

Continued Consolidation of the Refining Sector. We believe that the continuing consolidation in the refining industry may create attractive opportunities to acquire competitive refining capacity. During the period from 1990 to 2001, the percentage of refining capacity owned by major integrated oil companies decreased from 66% to 62%. Many integrated oil companies divested refining assets rather than making costly investments to meet increasingly strict product specifications. During this same period, the percentage of refining capacity owned by the top ten owners of refining assets increased from 57% to 69% and the share held by independent refiners increased from 16% to 33%. New environmental regulations will require the refining sector to make substantial investments in refining assets and pollution control technologies. We believe these substantial costs will likely force many smaller inefficient refiners out of the market.

Competitive Strengths

As a result of our transformation, we have developed the following strengths:

Refining Focus. We are a pure-play refiner, without the obligation to supply our own retail outlets or the cost of supporting our own retail brand. As a result, we are free to supply our products into the distribution

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channel or market that we believe will maximize profit. We do not own any other assets or businesses, such as petroleum exploration and production or retail distribution assets, that compete for capital or management attention. Therefore, our capital and attention are focused on improving our existing refineries and acquiring additional competitive refining capacity. Although many of our competitors are integrated oil companies that are better positioned to withstand market volatility, such competitors are not fully able to capitalize on periods of strong refining margins. See Competition.

Significant Refineries Located in Key Geographic Regions. Our Port Arthur and Lima refineries are logistically well located, modern facilities of significant size and scope with access to a wide variety of crude oils and product distribution systems. Our access to key port locations on the Gulf Coast enables us to ship waterborne crude oil to our Midwest refineries via major pipeline systems. Our Lima refinery provides us with a strong presence in the attractive PADD II market. This refinery also benefits from the facts that the Midwest region is dependent upon the import of supplies from outside the region and that the pipelines available to deliver products to the region are fully utilized, which effectively places a ceiling on external supply into the region, giving local refineries such as ours a logistical advantage. Therefore, any disruption in local refinery production or pipeline supply magnifies this supply shortage.

Significant Capacity to Process Low-Cost Heavy Sour Crude Oil. Our Port Arthur refinery, which possesses one of the largest coking units in the world, can process 80% heavy sour crude oil which gives us a cost advantage over other refiners that are not able to process high volumes of these less expensive crude oils.

Favorable Crude Oil Supply Contract with PEMEX Affiliate. We have a long-term heavy sour crude oil supply agreement with an affiliate of PEMEX that provides a stable and secure supply of Maya crude oil. This contract, which currently covers approximately one-third of our company-wide crude oil requirements, contains a mechanism intended to provide us with a minimum average coker gross margin and to moderate fluctuations in coker gross margins during an eight-year period beginning April 1, 2001. Essentially, if the formula-based coker gross margin set forth in the contract, which is calculated on a cumulative quarterly basis, results in a shortfall from the support amount of $15 per barrel, we receive discounts from the PEMEX affiliate. In the event that there is a recovery of a prior shortfall upon which we received a discount from the PEMEX affiliate, we would reimburse the PEMEX affiliate in the form of a crude oil premium. Since we are not required to pay premiums in excess of accumulated net shortfalls, we retain the benefit of net cumulative surpluses in our coker gross margins as compared to the support amount of $15 per barrel. For purpose of comparison, the $15 per barrel minimum average coker gross margin support amount equates to a WTI/Maya crude oil price differential of approximately $6 per barrel using market prices during the period from 1988 to September 2002, which slightly exceeds actual market differentials during that period. See Refinery Operations Gulf Coast Operations Port Arthur Refinery for a further discussion of this contract.

Experienced and Committed Growth-Oriented Management Team. Our chairman and chief executive officer, Thomas D. O Malley, has a proven track record in the refining industry. From 1990 to 2001 Mr. O Malley was chairman and chief executive officer of Tosco Corporation. During that period, Mr. O Malley led Tosco Corporation through a period of significant growth in operations and shareholder returns through acquisitions. At Premcor, Mr. O Malley has assembled an experienced and committed management team consisting of executives who have held management positions in growth-oriented organizations in the energy sector.

Business Strategies

Our goal is to be a premier independent refiner and supplier of unbranded petroleum products in the United States and to be an industry leader in growing shareholder value. We intend to accomplish this goal, grow our business, enhance earnings and improve our return on capital by executing the following strategies, which we believe capitalize on our existing competitive strengths.

Grow Through Acquisitions and Discretionary Capital Expenditure Projects at Our Existing Refineries. We intend to pursue timely and cost-effective acquisitions of crude oil refining capacity and undertake discretionary capital expenditure projects to improve, upgrade, and potentially expand our Port Arthur and Lima refineries. We will pursue opportunities that we believe will be promptly accretive to earnings and improve our return on capital, assuming historic average margins and crude oil differentials.

We believe that the continuing consolidation in our industry, the strategic divestitures by major integrated oil companies and the rationalization of specific refinery assets by merging companies will present us with attractive acquisition opportunities. We are currently evaluating several refinery acquisitions, some of which may be significant. In addition, based upon our engineering and financial analysis, we have identified discretionary capital projects at our Port Arthur and Lima refineries that we believe should, if undertaken, be accretive to earnings and generate an attractive return on capital. For example, in conjunction with a project to comply with new diesel fuel specifications, we have initiated a project at our Port Arthur refinery to expand this refinery to 300,000 - 400,000 bpd. We are also currently evaluating potential projects to reconfigure our Lima refinery to process a more sour and heavier crude slate. The management team assembled by Mr. O Malley has a proven track record of growing businesses via acquisitions, which we believe complements an existing strength of our organization. Since 1995, we have demonstrated our expertise in evaluating, structuring, implementing and integrating projects, as well as our acquisition and technical abilities by transforming our asset base through the acquisition of, and subsequent performance enhancement at, our Port Arthur and Lima refineries. We believe we are well situated to capitalize on these acquisitions and discretionary capital project opportunities.

In executing the strategies outlined above, we want to own and operate refineries, whether they be our existing refineries or refineries we may acquire in the future, which not only prosper in good market conditions, but are resilient during downturns in the market. We believe this resiliency can be created by, among other things:

- being a low-cost operator of safe and reliable refineries with a continuous focus on controlling costs;
- having an inherent cost advantage due to lower feedstock costs, such as the cost advantage which comes from having significant sour and heavy sour crude oil processing capabilities;
- owning refineries in strategic geographic locations; and
- having the capability to produce and distribute a variety of the fuels required by varying regional fuel specifications.

Promote Operational Excellence in Safety and Reliability. We will continue to devote significant time and resources toward improving the safety and reliability of our operations. We will seek to increase operating performance through our commitment to our preventative maintenance program and to training and development programs such as our current proactive manufacturing and defect elimination programs. We will continue to emphasize safety in all aspects of our operations. We believe that a superior safety record is inherently tied to profitability and that safety can be measured and managed like all other aspects of our business. We have identified several projects designed to increase our operational excellence. For example, at our Port Arthur refinery we are pursuing a portfolio of projects designed to increase reliability. At Lima, we have identified and are implementing a number of projects designed to decrease energy consumption and improve safety.

Create an Organization Highly Motivated to Enhance Earnings and Improve Return on Capital. We intend to create an organization in which employees are highly motivated to enhance earnings and improve return on capital. In order to create this motivation, we have adopted a new annual incentive program under which the annual bonus award for every employee in the organization is dependent to a substantial degree upon earnings. The primary parameter for determining bonus awards under the program for our executive officers and our senior level management team members is earnings. The program allows our executive officers and other senior

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management team members to earn annual bonus awards only if certain predetermined earnings levels are met, but provides significant bonus opportunities if those levels are exceeded. For the remainder of our employees, earnings is a substantial factor which determines whether a bonus pool is available for annual rewards. In approving annual awards under the program, the compensation committee of our board of directors will also consider our return on capital, and our environmental, health and safety performance.

Refinery Operations

We currently own and operate two refineries: our Port Arthur, Texas refinery comprises our Gulf Coast operations; our Lima, Ohio refinery comprises our Midwest operations.

In late September 2002, we ceased operations at our Hartford, Illinois refinery. We concluded that there was no economically viable manner of reconfiguring the refinery to produce fuels which meet new gasoline and diesel fuel specifications mandated by the federal government. We are pursuing all strategic options, including expanding the uses of the petroleum product and distribution facility and selling or leasing the refinery, to mitigate the loss of jobs and refining capacity in the Midwest. For a discussion of the pretax charge to earnings that we recorded in 2002 as a result of the closure of our Hartford refinery, see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001 Refinery Restructuring and Other Charges Hartford Refinery Closure.

Our aggregate crude oil throughput capacity at our two refineries is 420,000 bpd. The configuration at each of our refineries is single-train coking, which means that each of our refineries has a single crude unit and a coker unit. The following table provides a summary of key data for our refineries, excluding the now closed Hartford refinery, as of September 30, 2002 and for the nine months then ended.

Refinery Overview

	Port Arthur, Texas	Lima, Ohio	Combined
Crude distillation capacity (bpd)	250,000	170,000	420,000
Crude slate capability:			
Heavy sour	80%	%	48%
Medium and light sour	20	10	16
Sweet		90	36
Total	100%	100%	100%
Production			
Light products:			
Conventional gasoline	33.0%	53.6%	40.2%
Premium and reformulated gasoline	8.5	8.4	8.5
Diesel fuel	25.6	12.8	21.1
Jet fuel	11.0	16.2	12.8
Petrochemical feedstocks	7.2	5.5	6.6
Subtotal light products	85.3	96.5	89.2
Petroleum coke and sulfur	11.8	2.0	8.4
Residual oil	2.9	1.5	2.4
Total production	100.0%	100.0%	100.0%

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Products

Our principal refined products are gasoline, on and off-road diesel fuel, jet fuel, liquefied petroleum gas, petroleum coke and residual oil. Gasoline, on-road (low-sulfur) diesel fuel and jet fuel are primarily transportation fuels. Off-road (high-sulfur) diesel fuel is used mainly in agriculture and as railroad fuel. Liquefied petroleum gas is used mostly for home heating and as chemical and refining feedstocks. Petroleum coke, a by-product of the coking process, can be burned for power generation or used to process metals. Residual oil (slurry oil and vacuum tower bottoms) is used mainly as heavy industrial fuel, such as for power generation, or to manufacture roofing materials or create asphalt for highway paving. We also produce many unfinished petrochemical feedstocks that are sold to neighboring chemical plants at our Port Arthur and Lima refineries.

Gulf Coast Operations

The Gulf Coast, or PADD III, region of the United States, which is the largest PADD in the United States in terms of crude oil throughput capacity, is comprised of Alabama, Arkansas, Louisiana, Mississippi, New Mexico and Texas. According to the NPRA, 56 refineries were operating in PADD III as of December 31, 2001, with a total crude oil throughput capacity of approximately 7.5 million bpd.

The market has historically had an excess supply of products, with the EIA estimating light product demand, as of December 31, 2001, at approximately 2.2 million bpd and light product production at approximately 6.0 million bpd. Approximately 62%, or 3.7 million barrels, is exported mainly to the eastern seaboard or midwest markets.

Explorer, TEPPCO, Seaway and Phillips pipelines transport Gulf Coast product to markets located in the Midwest region, and the Colonial and Plantation pipelines transport products to markets located in the northeast and southeast United States. In addition to the product pipeline system, product can be shipped by barge and tanker to both the eastern seaboard and west coast markets.

Port Arthur Refinery

Our Port Arthur refinery is located on the Gulf Coast, which accounts for 47% of total domestic refining capacity and is one of the most competitive markets in the United States. We acquired the refinery from Chevron Products Company in February 1995. This refinery is located in Port Arthur, Texas approximately 90 miles east of Houston on a 4,000-acre site, of which less than 1,500 acres are occupied by refinery assets. Since acquiring the refinery, we have increased the crude oil throughput capacity from approximately 178,000 bpd to its current 250,000 bpd and expanded the refinery s ability to process heavy sour crude oil. The refinery now has the ability to process 100% sour crude oil, including up to 80% heavy sour crude oil. The refinery includes a crude unit, a catalytic reformer, a hydrocracker, a FCC unit, a delayed coker and a hydrofluoric acid alkylation unit. It produces conventional gasoline, reformulated gasoline, low-sulfur diesel fuel and jet fuel, petrochemical feedstocks, sulfur and fuel grade coke.

The heavy oil upgrade project at our Port Arthur refinery increased from 20% to 80% the refinery s capability of processing heavy sour crude oil. The project achieved mechanical completion in December 2000 and became fully operational in the first quarter of 2001. Both milestones were achieved on time and under budget. Final completion was achieved on December 28, 2001.

The project, which cost approximately $830 million, involved the construction of new coking, hydrocracking and sulfur removal capabilities and upgrades to existing units and infrastructure. According to Purvin & Gertz, the 80,000 bpd coker unit at the refinery is one of the largest in the world. The upgrades completed in 2000 included improvements to the crude unit, which increased crude oil throughput capacity from 232,000 bpd to 250,000 bpd. Our Port Arthur refinery is now particularly well suited to process significantly greater quantities of lower-cost heavy sour crude oil. The heavy oil upgrade project has significantly improved the financial performance of the refinery. Our subsidiary, PACC, which owns the coker, the hydrocracker, the sulfur removal unit and related assets and equipment and leases the crude unit and the hydrotreater from another

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of our subsidiaries, The Premcor Refining Group, sells the refined products and intermediate products produced by the heavy oil processing facility to The Premcor Refining Group pursuant to arm s length pricing formulas based on public market benchmark prices. The Premcor Refining Group then sells these products to third parties.

Feedstocks and Production at Port Arthur Refinery

	For the Year Ended December 31,						For the Nine Months Ended September 30, 2002	
	1999		2000		2001			
	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total
Feedstocks								
Crude oil throughput:								
Sweet crude oil	10.4	5.0%	3.6	1.7%		%		%
Medium and light sour crude oil	156.2	75.8	155.1	74.9	48.3	20.0	39.5	16.8
Heavy sour crude oil	33.4	16.2	43.4	21.0	181.5	75.2	189.6	80.8
Total crude oil	200.0	97.0	202.1	97.6	229.8	95.2	229.1	97.6
Unfinished and blendstocks	6.0	3.0	5.0	2.4	11.4	4.8	5.7	2.4
Total feedstocks	206.0	100.0%	207.1	100.0%	241.2	100.0%	234.8	100.0%
Production								
Light products:								
Conventional gasoline	75.9	36.4%	73.4	34.9%	82.9	32.7%	83.5	33.0%
Premium and reformulated gasoline	15.6	7.5	18.1	8.6	24.4	9.6	21.6	8.5
Diesel fuel	61.1	29.3	58.0	27.5	77.2	30.4	64.7	25.6
Jet fuel	18.1	8.7	16.6	7.9	19.7	7.8	27.7	11.0
Petrochemical feedstocks	23.1	11.1	23.7	11.3	18.3	7.2	18.3	7.2
Total light products	193.8	93.0	189.8	90.2	222.5	87.7	215.8	85.3
Petroleum coke and sulfur	11.1	5.3	11.3	5.3	26.5	10.4	29.9	11.8
Residual oil	3.6	1.7	9.5	4.5	4.8	1.9	7.3	2.9
Total production	208.5	100.0%	210.6	100.0%	253.8	100.0%	253.0	100.0%

Our Port Arthur refinery has significantly reduced combined recordable injuries and lost time injuries as defined by OSHA. The refinery s recordable injury rate, which reflects the number of recordable incidents per 200,000 hours worked, has improved from 4.40 in 1995 to an average of 1.39 as of September 30, 2002, compared to a United States refining industry average recordable injury rate of 1.35 in 2001. From August 1997 through the third quarter of 2001, our Port Arthur refinery accumulated over seven million employee hours without a lost time injury. The streak ended on October 4, 2001 when the refinery incurred its first lost time injury in over four years.

Feedstock and Other Supply Arrangements. The refinery s Texas Gulf Coast location is close to the major heavy sour crude oil producers and permits access to many cost-effective domestic and international crude oil sources via waterborne delivery to the refinery dock or from two terminals, the Sun terminal and the Oiltanking Beaumont Inc. terminal at Nederland, Texas, and through the Equilon pipeline. We purchase approximately 200,000 bpd of heavy sour crude oil, or 80% of the refinery s daily crude oil processing capacity, via waterborne delivery from an affiliate of PEMEX under term crude oil supply agreements, one of which is a long-term agreement with PACC expiring in 2011. Under this long-term agreement, PEMEX guarantees its affiliate s obligations to us. The remaining 20% of processing capacity utilizes a medium sour crude oil, the sourcing of which is optimally allocated between foreign waterborne crude oil and domestic offshore Gulf Coast sour crude oil delivered by pipeline.

Waterborne crude oil is delivered to the refinery docks or via the Sun terminal or the Oiltanking Beaumont terminal, both of which are connected by pipeline to our Lucas tank farm for redelivery to the refinery. Pipeline crude oil can also be received from Equilon s pipeline originating in Clovelly, Louisiana.

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The long-term crude oil supply agreement with the PEMEX affiliate provides our subsidiary, PACC, with a stable and secure supply of Maya crude oil. The long-term crude oil supply agreement includes a price adjustment mechanism designed to minimize the effect of adverse refining margin cycles and to moderate the fluctuations of the coker gross margin, a benchmark measure of the value of coker production over the cost of coker feedstock. This price adjustment mechanism contains a formula that represents an approximation of the coker gross margin and provides for a minimum average coker gross margin of $15 per barrel over the first eight years of the agreement, which began on April 1, 2001. The agreement expires in 2011.

On a monthly basis, the coker gross margin, as defined in the agreement, is calculated and compared to the minimum. Coker gross margins exceeding the minimum are considered a surplus while coker gross margins that fall short of the minimum are considered a shortfall. On a quarterly basis, the surplus and shortfall determinations since the beginning of the contract are aggregated. Pricing adjustments to the crude oil we purchase are only made when there exists a cumulative shortfall. When this quarterly aggregation first reveals that a cumulative shortfall exists, we receive a discount on our crude oil purchases in the next quarter in the amount of the cumulative shortfall. If, thereafter, the cumulative shortfall incrementally increases, we receive additional discounts on our crude oil purchases in the succeeding quarter equal to the incremental increase, and conversely, if, thereafter, the cumulative shortfall incrementally decreases, we repay discounts previously received, or a premium, on our crude oil purchases in the succeeding quarter equal to the incremental decrease. Cash crude oil discounts received by us in any one quarter are limited to $30 million, while our repayment of previous crude oil discounts, or premiums, are limited to $20 million in any one quarter. Any amounts subject to the quarterly payment limitations are carried forward and applied in subsequent quarters.

As of September 30, 2002, a cumulative quarterly surplus of $61.7 million existed under the contract. As a result, to the extent we experience quarterly shortfalls in coker gross margins going forward, the price we pay for Maya crude oil in succeeding quarters will not be discounted until this cumulative surplus is offset by future shortfalls. Assuming the WTI less Maya crude oil differential continues at its third quarter 2002 average of $4.92 per barrel, and assuming a Gulf Coast 3/2/1 crack spread similar to the third quarter 2002 average of $2.64 per barrel, we estimate the current $61.7 million cumulative surplus would be fully reversed after the third quarter of 2003. At that time, assuming a continuation of weak market conditions, we would be eligible to receive discounts on our crude oil purchases under the PEMEX contract as described above.

In May 2001, we entered into marine charter agreements with The Sanko Steamship Co., Ltd. of Tokyo, Japan, for three tankers custom designed for delivery to our docks. We intend to use the ships solely to transport Maya crude oil from the loading port in Mexico to our refinery dock in Port Arthur. Because of the custom design of the tankers, our dock will be accessible 24 hours a day by the tankers, unlike the daylight-only transit requirement applicable to ships approaching all other terminals in the Port Arthur area. In addition, the size of the custom-designed tankers will allow our crude oil requirements to be satisfied with fewer trips to the docks. We believe our marine charter arrangement will improve delivery reliability of crude oil to the Port Arthur refinery and will save approximately $10 million per year due to reduced third party terminal costs and the benefit of fewer trips. As of late 2002, all three ships had been delivered to us. The charter agreements have an eight-year term from the date of delivery of each ship and are renewable for two one-year periods.

Hydrogen is supplied to the refinery under a 20-year contract with Air Products and Chemicals Inc., or Air Products. Air Products has constructed, on property leased from us, a new steam methane reformer and two hydrogen purification units. Air Products also supplies steam and electricity to our Port Arthur refinery. If our requirements exceed the daily amount provided for under the contract, we may purchase additional hydrogen from Air Products. Certain bonuses and penalties are applicable for various performance targets under the contract.

Mixed butylenes from the FCC unit and the coker unit are processed for a fee by Huntsman Petrochemical Corporation, or Huntsman, to produce MTBE for sale or refinery consumption. The unused portion of the mixed butylene stream and incremental purchases are returned to our refinery for use as alkylation feedstock. Methanol

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required to produce the MTBE is purchased by us and delivered to Huntsman. The butylenes are transported to and from Huntsman by dedicated pipelines owned by Huntsman. This is a one-year renewable agreement between Huntsman and us, which may be cancelled upon 90 days notice.

We purchase Huntsman s entire production of pyrolysis gasoline, or pygas, produced from their Port Arthur ethylene cracker. Pygas is transported by dedicated pipeline from Huntsman to the refinery for use as a refinery gasoline blendstock. This agreement is for five years ending December 31, 2004, but can be cancelled by us, if desired as a result of gasoline specification changes due to Tier 2 gasoline standards, since the sulfur content of pygas may exceed that which is permitted by the regulations.

Energy. We generate most of the electricity for our Port Arthur refinery in our own cogeneration plants. The remainder of our electricity needs is supplied under a long-term agreement with Air Products, which has a cogeneration plant as part of its on-site hydrogen plant. In addition, we buy power from Entergy Gulf States, Inc., or Entergy, under peak load conditions, or if a generator experiences a mechanical failure. During times when we have excess power, we sell the excess to Entergy. Entergy has exercised its right to terminate the agreement because of impending deregulation, which deregulation is expected to occur in mid-2003. The agreement will stay in effect on a month-to-month basis until deregulation occurs. We are in the process of making alternative arrangements to replace the Entergy agreement.

Our Port Arthur refinery purchases natural gas at a price based on a monthly index, pursuant to a contract with Entex Gas Marketing, a subsidiary of Reliant Energy, that terminates in June 2003. The contract provides for 60,000 million btu of natural gas per day on a firm, uninterruptible basis, which is the amount of natural gas consumed by us each day at the refinery. The contract also allows for wide flexibility in volumes at a specified pricing formula. If we need to replace this contract, there are many alternative sources of natural gas available.

Product Offtake. The gasoline, low-sulfur diesel and jet fuel produced at our Port Arthur refinery are distributed into the Colonial pipeline, Explorer pipeline, TEPPCO pipeline or through the refinery dock into ships or barges. The advantage of a variety of distribution channels is that it gives us the flexibility to direct our product into the most profitable market. The TEPPCO pipeline is fed directly out of the refinery tankage, through pipelines we own and operate. The Colonial and Explorer pipelines are fed from our Port Arthur Products Station tank farm, which we partly own through a joint venture with Motiva Enterprises LLC and Unocal Pipeline Company, operated by Equilon Enterprises LLC, or Equilon. We also own the pipelines which distribute products from the refinery to the Port Arthur Products Station tank farm. Products loaded at the refinery docks come directly out of our Port Arthur refinery tankage. A pipeline also runs from our refinery to Equilon s Beaumont light products terminal. We supply all the products to the Equilon terminal. The petroleum coke produced is moved through the refinery dock by third-party shiploaders. The petroleum coke is sold to five customers under term agreements, for periods of one to four years.

Other Arrangements. Within our Port Arthur refinery, Chevron Phillips Chemical Company, L.P. operates a 164-acre petrochemical facility to manufacture olefins, benzene, cumene and cyclohexane. This facility is well integrated with the refinery and relies heavily on the refinery infrastructure for utility, operating and support services. We provide these services at cost. In addition to services, Chevron Phillips Chemical Company L.P. purchases feedstock from the refinery for use in its olefin cracker, aromatic extraction unit and propylene fractionator. By-products from the petrochemical facility are sold to the refinery for use as gasoline and diesel blendstock, saturate gas plant feedstock, hydrogen and fuel gas. Chevron Phillips Chemical Company L.P. has expressed intent to discontinue operation of the aromatic extraction unit. We are currently evaluating the impact of this discontinued operation on our refinery operations.

Chevron Products Company also operates a distribution facility on 102 acres within our Port Arthur refinery. The distribution center is operated by Chevron Products Company to blend, package, and distribute lubricants and grease. This facility also relies heavily on the refinery infrastructure for utility, operating and support services.

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Other Gulf Coast Assets

We own other assets associated with our Port Arthur refinery, including:

- a crude oil terminal and a liquefied petroleum gas terminal, with a combined capacity of approximately 5.0 million barrels;
- an interest in a jointly held product terminal operated by Equilon Pipeline Company;
- proprietary refined product pipelines that connect our Port Arthur refinery to our liquefied petroleum gas terminal;
- refined product common carrier pipelines that connect our Port Arthur refinery to several other terminals; and
- crude oil common carrier pipelines that connect our Port Arthur refinery to several other terminals and third party pipeline systems.

Midwest Operations

The Midwest, or PADD II, region of the United States, which is the second largest PADD in the United States in terms of crude oil throughput capacity, is comprised of North Dakota, South Dakota, Minnesota, Iowa, Nebraska, Kansas, Missouri, Oklahoma, Wisconsin, Illinois, Michigan, Indiana, Ohio, Kentucky and Tennessee. According to the NPRA, 27 refineries were operating in PADD II as of December 31, 2001, with a total crude oil throughput capacity of approximately 3.5 million bpd.

Production of light, or premium, petroleum product by refiners located in PADD II has historically been less than the demand for such product within that region, resulting in product being supplied from surrounding regions.

According to the EIA, total light product demand in PADD II, as of December 31, 2001, is approximately 3.9 million bpd, with refinery production of light products in PADD II estimated at approximately 2.9 million bpd. Net imports have supplemented PADD II refining in satisfying product demand and are currently estimated by the EIA at approximately 840,000 bpd, with the Gulf Coast continuing to be the largest area for sourcing product, accounting for approximately 670,000 bpd.

The Explorer, TEPPCO, Seaway, Orion, Colonial and Plantation pipelines are the primary pipeline systems for transporting Gulf Coast refinery output to PADD II. In addition, product began shipping via the Centennial product pipeline in April. Supply is also available via barge transport up the Mississippi River with significant deliveries into markets along the Ohio River. Although inefficient compared to pipelines, barge transport serves a role in supplying inland markets that are remote from pipeline access and in supplementing pipeline supply when they are bottlenecked or short of product.

Lima Refinery

Our Lima refinery, which we acquired from BP in August 1998, is located on a 650-acre site in Lima, Ohio, about halfway between Toledo and Dayton. The refinery, with a crude oil throughput capacity of approximately 170,000 bpd, processes primarily light, sweet crude oil, although 22,500 bpd of coking capability allows the refinery to upgrade lower-valued products. Our Lima refinery is highly automated and modern and includes a crude unit, a hydrocracker unit, a reformer unit, an isomerization unit, a FCC unit, a coker unit, a trolumen unit, an aromatic extraction unit and a sulfur recovery unit. We also own a 1.1 million-barrel crude oil terminal associated with our Lima refinery. The refinery can produce conventional gasoline, reformulated gasoline, jet fuel, high-sulfur diesel fuel, anode petroleum coke, benzene and toluene.

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Feedstocks and Production at Lima Refinery

	For the Year Ended December 31,						For the Nine Months Ended September 30, 2002	
	1999		2000		2001			
	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total	bpd (thousands)	Percent of Total
Feedstocks								
Crude oil throughput:								
Sweet crude oil	120.7	103.6%	130.5	99.5%	136.5	99.7%	137.7	102.0%
Light sour crude oil			5.9	4.5	4.0	2.9	3.3	2.4
Total crude oil	120.7	103.6	136.4	104.0	140.5	102.6	141.0	104.4
Unfinished and blendstocks	(4.2)	(3.6)	(5.3)	(4.0)	(3.6)	(2.6)	(6.0)	(4.4)
Total feedstocks	116.5	100.0%	131.1	100.0%	136.9	100.0%	135.0	100.0%
Production								
Light products:								
Conventional gasoline	55.2	46.7%	67.5	50.8%	71.2	51.4%	73.1	53.6%
Premium and reformulated gasoline	14.3	12.1	11.3	8.5	11.5	8.3	11.4	8.4
Diesel fuel	20.5	17.4	21.1	15.9	21.3	15.4	17.4	12.8
Jet fuel	17.7	15.0	21.4	16.1	22.7	16.4	22.1	16.2
Petrochemical feedstocks	6.4	5.4	7.1	5.3	7.0	5.1	7.5	5.5
Total light products	114.1	96.6	128.4	96.6	133.7	96.6	131.5	96.5
Petroleum coke and sulfur	2.5	2.1	2.5	1.9	2.8	2.0	2.8	2.0
Residual oil	1.5	1.3	2.0	1.5	2.0	1.4	2.0	1.5
Total production	118.1	100.0%	132.9	100.0%	138.5	100.0%	136.3	100.0%

Our Lima refinery crude oil input has not exceeded an annual average of 140,000 bpd over the last several years despite having a throughput capacity of approximately 170,000 bpd. This is largely due to the inability to market the incremental product, mainly high-sulfur diesel fuel, that is produced at throughput rates in excess of 140,000 bpd. A new pipeline connection between the Buckeye pipeline, which transports products out of Lima, and the TEPPCO pipeline, which delivers products into Chicago, was completed in August 2001. This connection in Indianapolis allows for the transportation of light products, specifically high-sulfur diesel fuel, to be transported into the Chicago market from our Lima refinery, thereby providing the opportunity to increase throughput rates closer to the 170,000 bpd capacity when economically justifiable. The ability to transport reformulated gasoline on this TEPPCO interconnection from our Lima refinery to the Chicago market was made available in late 2002, and we may utilize this connection for reformulated gasoline in 2003.

Our Lima refinery s combined recordable injuries and lost work days rate, or recordable injury rate, which reflects the number of recordable incidents per 200,000 hours worked, was an average of 1.59 as of September 30, 2002, as compared to a United States refining industry average recordable injury rate of 1.35 in 2001.

Feedstock and Other Supply Arrangements. The crude oil supplied to our refinery is purchased on a spot basis and delivered via the Marathon pipeline and the Mid-Valley pipeline. The reactivation and reversal of the Millennium pipeline in June 2000 allows the delivery of up to 65,000 bpd of foreign waterborne crude oil to the Mid-Valley pipeline at Longview, Texas. The Mid-Valley pipeline is also supplied with West Texas Intermediate domestic crude oil via the West Texas Gulf pipeline. The Marathon pipeline is supplied via the Capline, Ozark, Platte, ExxonMobil and Mustang pipelines. The current crude oil slate includes foreign waterborne crude oil ranging from heavy sweet to light sweet, domestic West Texas Intermediate and a small amount of light sour crude oil in order to maximize the sulfur plant capacity. This flexibility in crude oil supply helps to assure availability and allows us to minimize the cost of crude oil delivered into our refinery.

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In March 1999, we entered into an agreement with Koch Supply and Trading Group L.P., or Koch, as a means of minimizing our working capital investment. Pursuant to the agreement, we sold Koch our crude oil linefill in the Mid-Valley pipeline and the West Texas Gulf pipeline that is required for the delivery of crude oil to our Lima refinery, which amounted to 2.7 million barrels. As part of the agreement with Koch, we were required to repurchase these barrels of crude oil in September 2002. On October 1, 2002, Morgan Stanley Capital Group Inc., or MSCG, purchased the 2.7 million barrels of crude oil from Koch in lieu of our purchase obligation. We are obligated to repurchase the linefill from MSCG upon termination of our agreement with them. The initial term of that agreement continues through October 1, 2003 and thereafter the agreement automatically extends for additional 30 day periods unless terminated by either party. Because ownership of the linefill confers shipper status, MSCG is the shipper of record on all barrels delivered to Lima from the Mid-Valley pipeline. This routing is the primary source of West Texas Intermediate crude oil to the refinery. We also have the ability to transport foreign crude oils to the origin of the Mid-Valley pipeline for further delivery by way of the MSCG contract to Lima. All deliveries to Lima, whether domestic or foreign, are accomplished on a daily ratable basis.

Energy. Electricity is supplied to our refinery at a competitive rate pursuant to an agreement with Ohio Power Company, which is terminable by either party on twelve months notice. We believe this is a stable, long-term energy supply; however, there are alternative sources of electricity in the area if necessary. We purchase natural gas at a price based on a monthly index, pursuant to a contract with BP. The contract was renewed in August 2002 and renews automatically in August of each year, unless terminated by us on 120 days notice. If necessary, alternative sources of natural gas supply are available, although probably at higher prices.

Product Offtake. Our Lima refinery s products are distributed through the Buckeye and Inland pipeline systems and by rail, truck or third party-owned terminals. The Buckeye system provides access to markets in northern/central Ohio, Indiana, Michigan and western Pennsylvania. The Inland pipeline system is a private intra-state system through which products from our Lima refinery can be delivered to the pipeline s owners. A high percentage of our Lima refinery s production supplies the wholesale business through direct movements or exchanges. Gasoline and diesel fuel are sold or exchanged to the Chicago market under term arrangements. Jet fuel production is sold primarily under annual contracts to commercial airlines and delivered via pipelines. Propane products are sold by truck or, during the summer, transported via the TEPPCO pipeline to caverns for winter sale. The mixed butylenes and isobutane products are transported by rail to customers throughout the country. The anode grade petroleum coke production, which commands a higher price than fuel grade petroleum coke, is transported by rail to customers in West Virginia and Illinois.

Other Arrangements. Adjacent to our Lima refinery is a chemical complex owned and operated by BP Chemical, a plant owned by PCS Nitrogen and operated by BP Chemical, and a plant that processes by-products from the BP Chemical plant. The chemical complex relies heavily on our Lima refinery s infrastructure for utility, operating and support services. We provide these services at cost; however, costs for the replacement of capital are shared based on the proportion each party uses the equipment. In addition to services, BP Chemical purchases chemical grade propylene and normal butane for its plants.

We process BP s Toledo refinery production of low purity propylene. The low purity propylene is transported by pipeline to the refinery for purification. High purity propylene is purchased by BP Chemical and is received by rail or truck and commingled with high purity propylene production from the refinery to provide feed to the adjacent BP Chemical plant. This agreement has a seven-year term ending September 30, 2006, and continues year to year thereafter, unless terminated upon three years notice.

Hartford Refinery

Our Hartford refinery is located on a 400-acre site on the Mississippi River in Hartford, Illinois, approximately 17 miles northeast of St. Louis, Missouri. The refinery, which has a crude oil throughput capacity of approximately 70,000 bpd, is designed to process primarily sour crude oil into higher-value products such as gasoline and diesel fuel. The refinery includes a coker unit and can therefore process a wide variety of crude oil

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slates, including approximately 60% heavy sour crude oil and 40% medium and light sour crude oil or up to 100% medium sour crude oil. The refinery can produce conventional gasoline, reformulated gasoline, high-sulfur diesel fuel, residual fuel and petroleum coke. The refinery includes a crude unit, a hydrogen plant, an isomerization unit, a FCC unit, a coker unit and a hydrofluoric alkylation unit.

In late September 2002, we ceased refining operations at our Hartford refinery. We concluded there was no economically viable method of reconfiguring the refinery to produce fuels meeting new gasoline and diesel fuel specifications mandated by the federal government. We are pursuing all strategic options, including expanding the uses of the petroleum product and distribution facility and selling or leasing the refinery, to mitigate the loss of jobs and refining capacity in the Midwest. For a discussion of the pretax charge to earnings that we recorded in 2002 as a result of the closure of our Hartford refinery, see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001 Refinery Restructuring and Other Charges Hartford Refinery Closure. In October 2002, we announced our intention to operate our Hartford terminal facility on an on-going basis. The facility has total storage capacity of approximately 1.5 million barrels, of which we will utilize approximately 500,000 barrels for our wholesale activity.

Product Marketing

Our product marketing group sells approximately 2.2 billion gallons per year of gasoline, diesel fuel and jet fuel to a diverse group of approximately 750 distributors and chain retailers. We believe we are one of the largest suppliers of unbranded refined petroleum products in the United States. We sell the majority of our products through an extensive third-party owned terminal system in the midwest, southeast and eastern United States.

We also sell our products to end-users in the transportation and commercial sectors, including airlines, railroads and utilities.

In 1999, we sold our network of distribution terminals, with the exception of our Alsip terminal and two terminals affiliated with our Port Arthur refinery, to a group composed of Equiva Trading Company, Equilon Enterprises LLC and Motiva Enterprises LLC. As part of the transaction, we entered into a ten-year agreement with the group under which we have the right to distribute our refined products from our refineries through all of the group s extensive network of approximately 113 terminals, including the terminals we sold to the group. Our right to use the terminals is subject to availability and, as a result, our use of the terminals is sometimes limited. This agreement facilitates our strategy of expanding our wholesale business in Texas, the Southeast and eastern seaboard of the United States.

Our Alsip terminal is adjacent to our former Blue Island refinery (which is located approximately 17 miles from Chicago), which we closed in January 2001. We also own a dedicated pipeline that runs from the Alsip terminal to a Hammond, Indiana terminal owned by Equilon. Since the closure of the Blue Island refinery, we have been evaluating alternatives for optimizing the Alsip terminal. The terminal will continue to service the geographic niche market it has historically supplied with reformulated gasoline and distillates. We supply the terminal with products from our Port Arthur refinery via barge and via the Equilon terminal and from our Lima refinery via the Buckeye/TEPPCO pipeline.

A one million barrel refinery tank farm formerly associated with our Blue Island refinery is currently used to store crude oil, light products, ethanol, heavy oils and liquefied petroleum gas. Our refinery tank farm can receive products via Kinder Morgan, Capline and TEPPCO pipelines, barge, rail and through our proprietary pipeline from Equilon s Hammond terminal. Products can be shipped out of the refinery tank farm into the Kinder Morgan and Westshore pipelines, barges, railcars, trucks and via our pipeline back to Hammond where it can access the Wolverine pipeline, Badger pipeline and Buckeye pipeline. The location and variety of transportation into and out of the facility positions us well to supply the Chicago market or to lease our refinery tank farm to third parties.

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Our distribution network is an integral part of our refining business. However, due to ordinary course logistical issues concerning production schedules and product sales commitments, it is common for us to purchase refined products from third parties in order to balance the requirements of our product marketing activities. Less than 15% of net sales and operating revenues in 2001 were represented by sales of products purchased from third parties. This percentage was higher than normal in 2001 because we purchased refined products in order to cover shortfalls resulting from the closure of our Blue Island refinery. Although third party purchases are essential to effectively market our production, the effects from these activities on our operating results are not significant.

Crude Oil Supply

We have crude oil supply contracts with an affiliate of PEMEX pursuant to which we purchase approximately 200,000 bpd under two separate contracts. One of these contracts is a long-term agreement, under which we currently purchase approximately 162,000 bpd, designed to provide our Port Arthur refinery with a stable and secure supply of Maya heavy sour crude oil. We acquire the remainder of our crude oil supply on the spot market from unaffiliated foreign and domestic sources, allowing us to be flexible in our crude oil supply source. The following table shows our average daily sources of crude oil for the nine months ended September 30, 2002:

Sources of Crude Oil Supply

	Nine Months Ended September 30, 2002	
	bpd (thousands)	**Percent of Total**
Latin America		
Mexico	190.2	43.2%
Rest of Latin America	15.1	3.4
United States	143.8	32.7
Middle East	36.3	8.2
North Sea	21.4	4.9
Africa	15.4	3.5
Russia	15.3	3.5
Canada	2.5	0.6
Total	440.0	100.0%

In both of our operating regions, we have the flexibility to receive feedstocks from several suppliers using either pipelines or waterborne delivery. Our Port Arthur refinery receives Maya crude oil and light sour crude oil, which is delivered largely from third-party terminals and also through waterborne delivery via our docks. In the Midwest, we receive our crude oil largely through the Mid-Valley pipeline, the Capline pipeline and also under contract through the Millennium pipeline.

Competition

Many of our principal competitors are fully integrated national or multinational oil companies engaged in many segments of the petroleum business, including exploration, production, transportation, refining and marketing. Because of their geographic diversity, integrated operations, larger capitalization and greater resources, these competitors may be better able to withstand volatile market conditions, compete more effectively on the basis of price, and obtain crude oil more readily in times of shortage.

The refining industry is highly competitive. Among the principal competitive factors are feedstock supply and product distribution. We compete with other companies for supplies of feedstocks and for outlets for our refined products. Many of our competitors produce their own feedstocks and have extensive retail outlets. We do not produce any of our own feedstocks and have sold our retail outlets. The constant supply of feedstocks and ready market and distribution channels of such competitors places us at a competitive disadvantage in periods of feedstock shortage, high feedstock prices, low refined product prices or unfavorable distribution channel market conditions. In addition, competitors with their own production or retail outlets may be better able to withstand such periods of depressed refining margins or feedstock shortages because they can offset refining losses with profits from their production or retail operations.

Our industry is subject to extensive environmental regulations, including new standards governing sulfur content in gasoline and diesel fuel. These regulations will have a significant impact on the refining industry and will require substantial capital outlays by us and our competitors in order to upgrade our facilities to comply with the new standards. For further information on environmental compliance, see Environmental Matters Environmental Compliance. Competitors who have more modern plants than we do may not spend as much to comply with the regulations and may be better able to afford the upgrade costs.

Several significant merger transactions have recently closed between several of our refining industry competitors. We expect this trend toward industry consolidation and restructuring through a variety of transaction structures to continue. As a result of this consolidation, we believe, as has already been the case, that regulators will require merging parties to divest themselves of certain assets. In addition, other assets may also become available as the merged entities go through the process of rationalization regarding overlapping assets and production capability. As such, we believe that the continued consolidation and rationalization within the refining market may present us with attractive acquisition opportunities.

Employees

As of December 1, 2002, we employed approximately 1,413 people, with approximately 60% covered by collective bargaining agreements at our Lima and Port Arthur refineries. In October 2002, approximately 300 positions were terminated at our Hartford refinery in relation to its closure.

The collective bargaining agreement covering employees at our Port Arthur refinery expires in January 2006 and the agreement covering employees at our Lima refinery expires in April 2006. Our relationships with the relevant unions have been good and we have never experienced a work stoppage as a result of labor disagreements.

The Memphis refinery employs approximately 320 people, including support personnel. Approximately 50% of those employees are covered by a collective bargaining agreement expiring in January 2006. We intend to offer employment to the refinery s qualified represented employees and intend to consider the non-represented employees as candidates for employment.

Environmental Matters

We are subject to extensive federal, state and local laws and regulations relating to the protection of the environment. These laws and the accompanying regulatory programs and enforcement initiatives, some of which are described below, impact our business and operations by imposing, among other things:

- restrictions or permit requirements on our ongoing operations;
- liability in certain cases for the remediation of contaminated soil and groundwater at our current or former facilities and at facilities where we have disposed of hazardous materials; and
- specifications on the petroleum products we market, primarily gasoline and diesel fuel.

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The laws and regulations we are subject to change often and may become more stringent. The ultimate impact of complying with existing laws and regulations is not always clearly known or determinable due in part to the fact that our operations may change over time and certain implementing regulations for laws such as the Resource Conservation and Recovery Act and the Clean Air Act have not yet been finalized, are under governmental or judicial review or are being revised. These regulations and other new air and water quality standards and stricter fuel regulations could result in increased capital, operating and compliance costs. See Risk Factors Risks Related to our Business and our Industry Compliance with, and changes in, environmental laws could adversely affect our results of operations and our financial condition and Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Cash Flow from Investing Activities.

In addition, we are currently a party to a number of enforcement actions filed by federal, state and local agencies alleging violations of environmental laws and regulations and party to a number of third-party claims alleging exposure to hazardous substances, including asbestos. See Environmental Matters Certain Environmental Contingencies; Legal and Environmental Reserves and Legal Proceedings.

Environmental Compliance

The principal environmental risks associated with our refinery operations are air emissions, releases into soil and groundwater and wastewater excursions. The primary legislative and regulatory programs that affect these areas are outlined below.

The Clean Air Act

The Clean Air Act and the corresponding state laws that regulate emissions of materials into the air affect refining operations both directly and indirectly. Direct impacts on refining operations may occur through Clean Air Act permitting requirements and/or emission control requirements relating to specific air pollutants. For example, fugitive dust, including fine particulate matter measuring ten micrometers in diameter or smaller, may be subject to future regulation. The Clean Air Act indirectly affects refining operations by extensively regulating the air emissions of sulfur dioxide and other compounds, including nitrogen oxides, emitted by automobiles, utility plants and mobile sources, which are direct or indirect users of our products.

The Clean Air Act imposes stringent limits on air emissions, establishes a federally mandated operating permit program and allows for civil and criminal enforcement sanctions. The Clean Air Act also establishes attainment deadlines and control requirements based on the severity of air pollution in a geographical area.

In July 1997, the EPA promulgated more stringent National Ambient Air Quality Standards for ground-level ozone and fine particulate matter. In May 1999, a federal appeals court overturned the new standards. In February 2001, the United States Supreme Court affirmed in part, reversed in part, and remanded the case to the EPA to develop a reasonable interpretation of the nonattainment implementation provisions insofar as they relate to the revised ozone standards. Additionally, in 1998, the EPA published a final rule addressing the regional transport of ground-level ozone across state boundaries to the eastern United States through nitrogen oxide emissions reduction from various emissions sources, including refineries. The rule requires nineteen states and the District of Columbia to revise their state implementation plans to reduce nitrogen oxide emissions. In a related action in December 1999, the EPA granted a petition from several northeastern states seeking the adoption of stricter nitrogen oxide standards by midwestern states. The impact of the revised ozone and nitrogen oxide standards could be significant to us, but the potential financial effects cannot be reasonably estimated until the EPA takes further action on the revised ozone National Ambient Air Quality Standards, or any further judicial review occurs, and the states, as necessary, develop and implement revised state implementation plans in response to the revised ozone and nitrogen oxide standards.

At the Port Arthur refinery, we have committed to acquire permits for grandfathered emissions sources under the Governor s Clean Air Responsibility Enterprise program. To date, we have permitted 99% of the

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emissions from the refinery. We have been granted a flexible operating use permit for the refinery that allows us greater operational flexibility than we previously had, including the ability to increase throughput capacities, provided we do not exceed emissions thresholds set forth in the permit. In return for the flexible operating use permit, we agreed to install advanced pollution control technology at the refinery. We will begin our ninth year of a ten year schedule to install such technology.

The Clean Water Act

The federal Clean Water Act of 1972 affects refining operations by imposing restrictions on effluent discharge into, or impacting, navigable water. Regular monitoring, reporting requirements and performance standards are preconditions for the issuance and renewal of permits governing the discharge of pollutants into water. We maintain numerous discharge permits as required under the National Pollutant Discharge Elimination System program of the Clean Water Act and have implemented internal programs to oversee our compliance efforts. In addition, we are regulated under the Oil Pollution Act, which amended the Clean Water Act. Among other requirements, the Oil Pollution Act requires the owner or operator of a tank vessel or a facility to maintain an emergency oil response plan to respond to releases of oil or hazardous substances. We have developed and implemented such a plan for each of our facilities covered by the Oil Pollution Act. Also, in case of such releases, the Oil Pollution Act requires responsible companies to pay resulting removal costs and damages, provides for substantial civil penalties, and imposes criminal sanctions for violations of this law. The State of Texas, in which we operate, has passed laws similar to the Oil Pollution Act.

Ethanol and MTBE are the essential blendstocks for producing cleaner-burning gasoline. However, the presence of MTBE in some water supplies, resulting from gasoline leaks primarily from underground and aboveground storage tanks, has led to public concern that MTBE has contaminated drinking water supplies, thus posing a health risk, or has adversely affected the taste and odor of drinking water supplies. As a result of heightened public concern, California has banned the use of MTBE as a gasoline component in that state effective at the end of 2004. In addition, the federal legislature and other states have either passed or proposed or are considering proposals to restrict or ban the use of MTBE. We have primarily used ethanol as the blendstock for the reformulated gasoline we produce. We have, however, produced gasoline containing MTBE at our refineries, and we have sold MTBE to third parties for use as a blendstock for gasoline.

Resource Conservation and Recovery Act

Our refining operations are subject to Resource Conservation and Recovery Act requirements for the treatment, storage and disposal of hazardous wastes. When feasible, Resource Conservation and Recovery Act materials are recycled through our coking operations instead of being disposed of on-site or off-site. The Resource Conservation and Recovery Act establishes standards for the management of solid and hazardous wastes. Besides governing current waste disposal practices, the Resource Conservation and Recovery Act also addresses the environmental effects of certain past waste disposal operations, the recycling of wastes and the regulation of underground storage tanks containing regulated substances. In addition, new laws are being enacted and regulations are being adopted by various regulatory agencies on a continuing basis, and the costs of compliance with these new rules can only be broadly appraised until their implementation becomes more accurately defined.

Fuel Regulations

Reformulated Fuels. EPA regulations also require that reformulated gasoline and low-sulfur diesel intended for all on-road consumers be produced for ozone non-attainment areas, including Chicago, Milwaukee and Houston, which are in our direct market areas. In addition, because St. Louis is a voluntary participant in the EPA s ozone reduction program, reformulated gasoline and low-sulfur diesel is also required in the St. Louis market area, another of our direct market areas. Expenditures necessary to comply with existing reformulated fuels regulations are primarily discretionary. Our decision whether or not to make these expenditures is driven by market conditions and economic factors. The reformulated fuels programs impose restrictions on properties of fuels to be refined and marketed, including those pertaining to gasoline volatility, oxygenate content, detergent addition and sulfur content. The restrictions on fuel properties vary in markets in which we operate, depending on attainment of air quality standards and the time of year. Our Port Arthur refinery can produce up to approximately 60% of its gasoline production in reformulated gasoline. Its maximum reformulated gasoline production may be limited by the clean fuels attainment of our total refining system. Our Port Arthur refinery s diesel production complies with the current on-road sulfur specification of 500 ppm.

Tier 2 Motor Vehicle Emission Standards. In February 2000, the EPA promulgated the Tier 2 Motor Vehicle Emission Standards Final Rule for all passenger vehicles, establishing standards for sulfur content in gasoline. These regulations mandate that the average sulfur content of gasoline for highway use produced at any refinery not exceed 30 ppm during any calendar year by January 1, 2006. These requirements will be phased in beginning on January 1, 2004. We currently expect to produce gasoline under the new sulfur standards at the Port Arthur refinery prior to January 1, 2004 and, as a result of the corporate pool averaging provisions of the regulations, will not be required to meet the new sulfur standards at the Lima refinery until July 1, 2004, a six month deferral. A further delay in the requirement to meet the new sulfur standards at the Lima refinery through 2005 may be possible through the purchase of sulfur allotments and credits which arise from a refiner producing gasoline with a sulfur content below specified levels prior to the end of 2005, the end of the phase-in period. There is no assurance that sufficient allotments or credits to defer investment at the Lima refinery will be available, or if available, at what cost. We believe, based on current estimates and on a January 1, 2004 compliance date for both the Port Arthur and Lima refineries, that compliance with the new Tier 2 gasoline specifications will require capital expenditures for the Lima and Port Arthur refineries in the aggregate through 2005 of approximately $255 million. More than 95% of the total investment to meet the Tier 2 gasoline specifications is expected to be incurred during 2002 through 2004 with the greatest concentration of spending occurring in 2003.

Low Sulfur Diesel Standards. In addition, in January 2001, the EPA promulgated its on-road diesel regulations, which will require a 97% reduction in the sulfur content of diesel fuel sold for highway use by June 1, 2006, with full compliance by January 1, 2010. Regulations for off-road diesel requirements are pending. We estimate capital expenditures in the aggregate through 2006 required to comply with the diesel standards at our Port Arthur and Lima refineries of approximately $245 million. More than 95% of the projected investment is expected to be incurred during 2004 through 2006 with the greatest concentration of spending occurring in 2005. Since the Lima refinery does not currently produce diesel fuel to on-road specifications, we are considering an acceleration of the low-sulfur diesel investment at the Lima refinery in order to capture this incremental product value. If the investment is accelerated, production of the low-sulfur fuel is possible by the first quarter of 2005.

Maximum Achievable Control Technology. In addition, on April 11, 2002, the EPA promulgated regulations to implement Phase II of the petroleum refinery Maximum Achievable Control Technology rule under the federal Clean Air Act, referred to as MACT II, which regulates emissions of hazardous air pollutants from certain refinery units. We expect to spend approximately $45 million in the next three years in order to comply with the regulations with the greatest concentration of spending evenly spread out over 2003 and 2004.

Permits

Refining companies must obtain numerous permits that impose strict regulations on various environmental and safety matters in connection with oil refining. Once a permit application is prepared and submitted to the regulatory agency, it is subject to a completeness review, technical review and public notice and comment period before it can be approved. Depending on the size and complexity of the refining operation, some refining permits can take considerable time to prepare and often take six months to sometimes two years to be approved. Regulatory authorities have considerable discretion in the timing of the permit issuance and the public has rights to comment on and otherwise engage in the permitting process, including through intervention in the courts. However, certain pending proceedings involving our Port Arthur refinery allege permit violations. See Legal Proceedings.

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Environmental Remediation

Under the Comprehensive Environmental Response, Compensation and Liability Act, or CERCLA, and the Resource Conservation and Recovery Act and related state laws, certain persons may be liable for the release or threatened release of hazardous substances including petroleum and its derivatives into the environment. These persons include the current owner or operator of property where the release or threatened release occurred, any persons who owned or operated the property when the release occurred, and any persons who arranged for the disposal of hazardous substances at the property. Liability under CERCLA is strict, retroactive and in most cases involving the government as plaintiff is joint and several, so that any responsible party may be liable for the entire cost of investigating and remediating the release of hazardous substances. As a practical matter, however, liability at most CERCLA and similar sites is shared among all solvent potentially responsible parties. The liability of a party is determined by the cost of investigation and remediation, the portion of the hazardous substance(s) the party contributed to the site, and the number of solvent potentially responsible parties.

The release or discharge of crude oil, petroleum products or hazardous materials can occur at refineries and terminals. We have identified a variety of potential environmental issues at our refineries, terminals, and previously owned retail stores. In addition, each refinery has areas on-site that may contain hazardous waste or hazardous substance contamination that may need to be addressed in the future at substantial cost. The terminal sites may also require remediation due to the age of tanks and facilities and as a result of current or past activities at the terminal properties including several significant spills and past on-site waste disposal practices. See Risk Factors Risks Related to our Business and our Industry Environmental clean-up and remediation costs of our sites and environmental litigation could decrease our net cash flow, reduce our results of operations and impair our financial condition.

Port Arthur and Lima Refineries

The original refineries on the sites of our Port Arthur and Lima refineries began operating in the late 1800s and early 1900s, prior to modern environmental laws and methods of operation. There is contamination at these sites, which we believe will be required to be remediated. Under the terms of the 1995 purchase of our Port Arthur refinery, Chevron Products Company, the former owner, retained liability for all required investigation and remediation relating to pre-purchase contamination discovered by June 1997, except with respect to certain areas on or around which active processing units are located, which are our responsibility. Less than 200 acres of the 4,000-acre refinery site are occupied by active processing units. Extensive due diligence efforts prior to our acquisition and additional investigation after our acquisition documented contamination for which Chevron is responsible. In June 1997, we entered into an agreed order with Chevron and the Texas Commission on Environmental Quality, or TCEQ, that incorporates the contractual division of the remediation responsibilities for certain assets into an agreed order. We have accrued $11.9 million for our portion of the Port Arthur remediation as of September 30, 2002. Under the terms of the purchase of our Lima refinery, BP, the former owner, indemnified us, subject to certain time and dollar limits, for all pre-existing environmental liabilities, except for contamination resulting from releases of hazardous substances in or on sewers, process units, storage tanks and other equipment at the refinery as of the closing date, but only to the extent the presence of these hazardous substances was as a result of normal operations of the refinery and does not constitute a violation of any environmental law. Although we are not primarily responsible for the majority of the currently required remediation of these sites, we may become jointly and severally liable for the cost of investigating and remediating a portion of these sites in the event that Chevron or BP fails to perform the remediation. In such an event, however, we believe we would have a contractual right of recovery from these entities. The cost of any such remediation could be substantial and could have a material adverse effect on our financial position. See Risk Factors Risks Related to our Business and our Industry Environmental clean-up and remediation costs of our sites and environmental litigation could decrease our net cash flow, reduce our results of operations and impair our financial condition.

Blue Island Refinery Decommissioning and Closure

In January 2001, we ceased refining operations at our Blue Island refinery. The decommissioning, dismantling and tear down of the facility is underway. We are currently in discussions with federal, state and

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local governmental agencies concerning remediation of the site. The governmental agencies have proposed a remediation process patterned after national contingency plan provisions of CERCLA. We have proposed to the agencies a site investigation and remediation that incorporates certain elements of the CERCLA process and the State of Illinois site remediation program. Related to the closure of the facility, we accrued $56.4 million for decommissioning, remediation of the site and asbestos abatement. As of September 30, 2002, we had spent $34.0 million. In 2002, environmental risk insurance policies covering the Blue Island refinery site have been procured and bound, with final policies expected to be issued within the first quarter of 2003. This insurance program will allow us to quantify and, within the limits of the policy, cap our cost to remediate the site, and provide insurance coverage from future third party claims arising from past or future environmental releases. The remediation cost overrun policy has a term of ten years and, subject to certain exceptions and exclusions, provides $25 million in coverage in excess of a self-insured retention amount of $26 million. The pollution legal liability policy provides for $25 million in aggregate coverage and per incident coverage in excess of a $100,000 deductible per incident. For further discussion of the closure of our Blue Island refinery, see Management s Discussion and Analysis of Financial Condition and Results of Operations Factors Affecting Comparability Closure of Blue Island Refinery.

Hartford Refinery Closure

In September 2002, we ceased refining operations at our Hartford refinery. In the fourth quarter of 2002, we completed the removal of hydrocarbons, catalyst and chemicals from the refinery processing units. We are also currently in preliminary discussions with state governmental agencies concerning environmental remediation of the site. Related to the closure of the refinery, we have accrued $45.9 million for decommissioning, remediation of the site and asbestos abatement. As of September 30, 2002, we spent $5.6 million related primarily to the decommissioning of the facility. The accrual of $45.9 million assumes that a portion of the refinery will be operated on an on-going basis as part of a lease or sale transaction and that remediation will occur in non-operating portions of the refinery. In addition, state governmental agencies are investigating a large petroleum hydrocarbon plume underlying a portion of the Village of Hartford. Responsibility for the plume has not been determined and no enforcement action has been taken. Nonetheless, since the mid-1990s we have operated, on a voluntary basis, a vapor recovery system designed to prevent gasoline odors from rising into the homes in that area of Hartford overlying the plume. The final disposition of the refinery assets and the final outcome of our discussions with the governmental agencies will have a significant bearing on any necessary adjustments to this accrual. For further discussion of the closure of our Hartford Refinery see Management s Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001 Refinery Restructuring and Other Charges Hartford Refinery Closures.

Former Retail Sites

In 1999, we sold our former retail marketing business, which we operated from time to time on a total of 1,150 sites. During the normal course of operations of these sites, releases of petroleum products from underground storage tanks have occurred. Federal and state laws require that contamination caused by such releases at these sites be assessed and remediated to meet applicable standards. The enforcement of the underground storage tank regulations under the Resource Conservation and Recovery Act has been delegated to the states that administer their own underground storage tank programs. Our obligation to remediate such contamination varies, depending upon the extent of the releases and the stringency of the laws and regulations of the states in which the releases were made. A portion of these remediation costs may be recoverable from the appropriate state underground storage tank reimbursement fund once the applicable deductible has been satisfied. The 1999 sale included 672 sites, 225 of which had no known preclosure contamination, 365 of which had known pre-closure contamination of varying extent, and 80 of which had been previously remediated. The purchaser of our retail division assumed pre-closure environmental liabilities of up to $50,000 per site at the sites on which there was no known contamination. We are responsible for any liability above that amount per site for pre-closure liabilities, subject to certain time limitations. With respect to the sites on which there was known pre-

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closing contamination, we retained liability for 50% of the first $5 million in remediation costs and 100% of remediation costs over that amount. We retained any remaining pre-closing liability for sites that had been previously remediated.

In relation to the 1999 sale, we assigned approximately 170 leases and subleases of retail stores to the purchaser of our retail division, Clark Retail Enterprises, Inc., or CRE. We remain jointly and severally liable for CRE s obligations under approximately 150 of these leases, including payment of rent, taxes and environmental cleanup responsibilities for releases of petroleum occurring during the term of the leases. On October 15, 2002, CRE and its parent company, Clark Retail Group, Inc. filed a voluntary petition for reorganization under Chapter 11 of the U.S. Bankruptcy Code. Should CRE reject some or all of these leases, we may become responsible for these obligations. For further discussion of these lease obligations, see Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Cash Flow from Operating Activities.

Of the remaining 478 former retail sites not sold in the 1999 transaction described above, we have sold all but 8 in open market sales and auction sales. We generally retain the remediation obligations for sites sold in open market sales with identified contamination. Of the retail sites sold in auctions, we agreed to retain liability for all of these sites until an appropriate state regulatory agency issues a letter indicating that no further remedial action is necessary. However, these letters are subject to revocation if it is later determined that contamination exists at the properties and we would remain liable for the remediation of any property at which such a letter was received but subsequently revoked. We are currently involved in the active remediation of approximately 140 of the retail sites sold in open market and auction sales. We are actively seeking to sell the remaining 8 properties. During the period from the beginning of 1999 through September 30, 2002, we expended $20 million to satisfy the obligations described above and as of September 30, 2002, had $23.4 million accrued to satisfy those obligations in the future.

Former Terminals

In December 1999, we sold 15 refined product terminals to a third party, but retained liability for environmental matters at four terminals and, with respect to the remaining eleven terminals, the first $250,000 per year of environmental liabilities for a period of six years up to a maximum of $1.5 million. As of September 30, 2002, we had expended $0.8 million on these obligations and have accrued $2.6 million for these obligations in the future.

Certain Environmental Contingencies; Legal and Environmental Reserves

As a result of our activities, we and our subsidiaries are party to a number of environmental proceedings. Those that could have a material effect on our operations, or involve potential monetary sanctions of $100,000 or more and to which a governmental authority is a party, are described below under Legal Proceedings. We accrued a total of $99 million, on an undiscounted basis, as of September 30, 2002 for all legal and environmental contingencies and obligations, including those items described under Environmental Matters Environmental Remediation and Legal Proceedings. This accrual includes approximately $78 million as of September 30, 2002, for site clean-up and environmental matters associated with the Hartford and Blue Island closures and retail sites.

Environmental Outlook

We have incurred and will continue to incur substantial capital, operating and maintenance, and remediation expenditures as a result of environmental laws and regulations. To the extent these expenditures are not ultimately reflected in the prices of the products and services we offer, our operating results will be adversely affected. We believe that substantially all of our competitors are subject to similar environmental laws and regulations. However, the specific impact on each competitor may vary depending on a number of factors, including the age and location of its operating facilities, marketing areas, production processes and whether or not it is engaged in the petrochemical business or the marine transportation of crude oil or refined products.

Safety and Health Matters

We aim to achieve excellent safety and health performance. We measure our success in this area primarily through the use of injury frequency rates administrated by OSHA. We believe that a superior safety record is inherently tied to achieving our productivity and financial goals. We seek to implement this goal by:

- training employees in safe work practices;
- encouraging an atmosphere of open communication;
- involving employees in establishing safety standards; and
- recording, reporting and investigating all accidents to avoid reoccurrence.

From our acquisition of the Lima refinery in 1998 through the end of 2001 the refinery accumulated over three million employee hours without a lost time injury. From August 1997 through the third quarter of 2001 our Port Arthur refinery accumulated over seven million employee hours without a lost time injury. As of September 30, 2002, our refineries record of hours worked without a lost time accident stood at 4.7 million hours. Subsequent to September 30, 2002, we have experienced four OSHA recordable injury incidents.

Legal Proceedings

The following is a summary of material pending legal proceedings to which we or any of our subsidiaries are a party or to which any of our or their property is subject, and proceedings that involve potential monetary sanctions of $100,000 or more and to which a governmental authority is a party.

In addition to the specific matters discussed below, we also have been named in various other suits and claims. We believe that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on our consolidated financial condition, results of operations or liquidity. However, an adverse outcome of any one or more of these matters could have a material effect on quarterly or annual operating results or cash flow.

Port Arthur: Enforcement. The TCEQ conducted a site inspection of our Port Arthur refinery in the spring of 1998. In August 1998, we received a notice of enforcement alleging 47 air-related violations and 13 hazardous waste-related violations. The number of allegations was significantly reduced in an enforcement determination response from the TCEQ in April 1999. A follow-up inspection of the refinery in June 1999 concluded that only two items remained outstanding, namely that the refinery failed to maintain the temperature required by our air permit at one of its incinerators and that five process wastewater sump vents did not meet applicable air emission control requirements. The TCEQ also conducted a complete refinery inspection in the second quarter of 1999, resulting in another notice of enforcement in August 1999. This notice alleged nine air-related violations, relating primarily to deficiencies in our upset reports and emissions monitoring program, and one hazardous waste-related violation concerning spills. The 1998 and 1999 notices were combined and referred to the TCEQ s litigation division. On September 7, 2000 the TCEQ issued a notice of enforcement regarding our alleged failure to maintain emission rates at permitted levels. In May 2001, the TCEQ proposed an order covering some of the 1998 hazardous waste allegations (i.e., the incinerator temperature deficiency and the process wastewater sumps) and all of the 1999 and 2000 allegations, and proposing the payment of a fine of $562,675 and the implementation of a series of technical provisions requiring corrective actions. Negotiations with the TCEQ are ongoing.

Blue Island: Federal and State Enforcement. In September 1998, the federal government filed a complaint, *United States v. Clark Refining & Marketing, Inc.,* alleging that our Blue Island refinery violated

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federal environmental laws relating to air, water and solid waste. The Illinois Attorney General intervened in the case. The State of Illinois and Cook County had brought an action several years earlier, *People ex rel. Ryan v. Clark Refining & Marketing, Inc.,* also alleging violations under environmental laws. In the first quarter of 2002, we reached an agreement to settle both cases. The consent order in the state case was formally approved and entered by the state court on April 8, 2002, and the federal court approved the settlement on June 12, 2002. The consent order in the federal case required payments totaling $6.25 million as civil penalties (plus $0.1 million in interest), which the Company paid on July 12, 2002, and requires permit modifications and limited ongoing monitoring at the now-idled refinery. The consent order in the state case requires an ongoing tank inspection program along with enhanced release reporting obligations and reporting of decommissioning/dismantling plans, payment of a civil penalty of $24,000 and payment of the state s engineering consultant fees of to a maximum of $75,000. The consent order for the state case was approved by the state court in the second quarter of 2002.

Blue Island: Criminal Matters. In June 2000, PRG pled guilty to one felony count of violating the Clean Water Act and one count of conspiracy to defraud the United States at our Blue Island refinery. These charges arose out of the discovery, during an EPA investigation at the site conducted in 1996, that two former employees had allegedly falsified certain reports regarding wastewater sent to the municipal wastewater treatment facility. As part of the plea agreement, PRG agreed to pay a fine of $2 million and was placed on probation for three years beginning September 22, 2000. We do not anticipate that the probation of PRG will have a significant adverse impact on our business on an ongoing basis. The primary remaining condition of its probation is an obligation not to commit future environmental crimes. If PRG were to commit a crime in the future, it would be subject not only to prosecution for that new violation, but also to a separate charge that it had violated a condition of its probation. Any violation of probation charge would be brought before the same judge who entered the original sentence, and that judge would have the authority to enter a new and potentially more severe sentence for the offense to which PRG pled guilty in June 2000. One of the former employees pled guilty to a misdemeanor charge and was placed on one year probation and another former employee was found guilty on felony charges and sentenced to 21 months in prison related to these events.

Blue Island: Class Action Matters. In October 1994, our Blue Island refinery experienced an accidental release of used catalyst into the air. In October 1995, a class action, *Rosolowski v. Clark Refining & Marketing, Inc., et al.,* was filed against us seeking to recover damages in an unspecified amount for alleged property damage and personal injury resulting from that catalyst release. The complaint underlying this action was later amended to add allegations of subsequent events that allegedly diminished property values. In June 2000, our Blue Island refinery experienced an electrical malfunction that resulted in another accidental release of used catalyst into the air. Following the 2000 catalyst release, two cases were filed purporting to be class actions, *Madrigal et al. v. The Premcor Refining Group Inc.* and *Mason et al. v. The Premcor Refining Group Inc.* Both cases seek damages in an unspecified amount for alleged property damage and personal injury resulting from that catalyst release. These cases have been consolidated for the purpose of conducting discovery, which is currently proceeding.

Sashabaw Road Retail Location: State Enforcement. In July 1994, the Michigan Department of Natural Resources brought an action alleging that one of our retail locations caused groundwater contamination, necessitating the installation of a new $600,000 drinking water system. The Michigan Department of Natural Resources sought reimbursement of this cost. Although our site may have contributed to contamination in the area, we maintained that numerous other sources were responsible and that a total reimbursement demand from us would be excessive. Mediation resulted in a $200,000 finding against us. We made an offer of judgment equal to the mediation finding. The Michigan Department of Natural Resources rejected the offer and the matter was tried in November 1999, resulting in a judgment against us of $110,000 plus interest. Since the judgment was over 20% below our previous settlement offer, under applicable state law we are entitled to recover our legal fees. Both the Michigan Department of Natural Resources and we appealed the decision. The appellate court rendered its decision on January 10, 2003 and affirmed the trial court s ruling in all respects. The parties have until January 31, 2003 to file an appeal with the Michigan Supreme Court. If the Michigan Department of Natural Resources does not file an appeal, it will owe us mediation sanctions which should net us approximately $100,000.

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Port Arthur Natural Resource Damage Assessment. In 1999, we and Chevron Products Company were notified by a number of federal and Texas agencies that a study would be conducted to determine whether any natural resource damage occurred as a result of the operation of our Port Arthur refinery prior to January 1, 2000. We are cooperating with the governmental agencies in this investigation. We have entered into an agreement with Chevron Products Company pursuant to which Chevron Products Company will indemnify us for any future claims in consideration of a payment of $750,000, which we paid in October 2001.

Alleged Asbestos Exposure. We, along with numerous other defendants, have recently been named in approximately 22 individual lawsuits alleging personal injury resulting from exposure to asbestos. A majority of the claims have been filed by employees of third-party independent contractors who purportedly were exposed to asbestos while performing services at our Hartford refinery. We have recently been voluntarily dismissed in 17 of the lawsuits in which we have been named. The remainder are in the early stages of litigation. Substantive discovery has not yet been concluded. It is impossible at this time for us to quantify our exposure from these claims, but, based on currently available information, we do not believe that any liability resulting from the resolution of these matters will have a material adverse effect on our financial condition, results of operations and cash flow.

New Source Review Permit Issues

New Source Review requirements under the Clean Air Act apply to newly constructed facilities, significant expansions of existing facilities, and significant process modifications and requires new major stationary sources and major modifications at existing major stationary sources to obtain permits, perform air quality analysis and install stringent air pollution control equipment at affected facilities. The EPA has commenced an industry-wide enforcement initiative regarding New Source Review. The current EPA initiative, which includes sending numerous refineries information requests pursuant to Section 114 of the Clean Air Act, appears to target many items that the industry has historically considered routine repair, replacement, maintenance or other activity exempted from the New Source Review requirements.

We have responded to an information request from the EPA regarding New Source Review compliance at our Port Arthur and Lima refineries, both of which were purchased within the last seven years. We believe that any costs to respond to New Source Review issues at those refineries prior to our purchase are the responsibility of the prior owners and operators of those facilities. We responded to the request in late 2000, providing information relating to our period of ownership, and are awaiting a response.

In July 2001, we settled a lawsuit with the EPA and the State of Illinois that resolved, among other historic compliance issues, a New Source Review issue resulting from repairs made to the FCC unit at our Hartford refinery in 1994. In settlement of the lawsuit, we agreed to install a wet gas scrubber on the FCC unit and low nitrogen oxide burners and agreed to pay a civil penalty of $2 million. As a result of the closure of the Hartford refinery in September 2002, we do not anticipate making these capital expenditures.

The federal and state enforcement action at the Blue Island refinery, which was settled in the second quarter of 2002 with the EPA and the State of Illinois, also includes New Source Review issues. In settlement of this litigation, we agreed to pay a civil penalty of $6.25 million, and to modify permits and perform limited monitoring at the now-idled refinery and active terminal. For a description of the litigation at the Blue Island refinery, see Legal Proceedings Blue Island: Federal and State Enforcement.

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MANAGEMENT

Directors and Executive Officers

Our directors, executive officers, their ages as of January 1, 2003, and their positions with us are set forth in the table below.

Name	Age	Position
Thomas D. O Malley	61	Chairman of the Board and Chief Executive Officer
Jefferson F. Allen*	57	Director
Stephen I. Chazen*	56	Director
Marshall A. Cohen*	67	Director
David I. Foley	35	Director
Robert L. Friedman	59	Director
Richard C. Lappin	58	Director
Wilkes McClave III	55	Director
Henry M. Kuchta	46	President and Chief Operating Officer
William E. Hantke	55	Executive Vice President and Chief Financial Officer
Dennis R. Eichholz	49	Senior Vice President Finance and Controller
Michael D. Gayda	48	Senior Vice President, General Counsel and Secretary
James R. Voss	36	Senior Vice President and Chief Administrative Officer
Joseph D. Watson	37	Senior Vice President Corporate Development
Gregory R. Bram	38	Refinery Manager Lima Refinery
Donovan J. Kuenzli	63	Refinery Manager Port Arthur Refinery

* Member of the Audit Committee
Member of the Compensation Committee
Member of the Committee on Governance

Thomas D. O Malley has served as our chairman of the board of directors and chief executive officer since February 2002 and served as our president from February 2002 until January 2003. Mr. O Malley served as vice chairman of the board of Phillips Petroleum Company from the consummation of that company s acquisition of Tosco Corporation in September 2001 until January 2002. Mr. O Malley served as chairman and chief executive officer of Tosco from January 1990 to September 2001 and president of Tosco from May 1993 to May 1997 and from October 1989 to May 1990. He currently serves on the board of directors of Lowe s Companies, Inc. and PETsMART, Inc.

Jefferson F. Allen has served as a director since February 2002. From June 1990 to September 2001, Mr. Allen served in various positions with Tosco Corporation, most recently serving as Tosco s president and chief financial officer. From November 1988 to June 1990, Mr. Allen served in various positions at Comfed Bancorp, Inc., including chairman and chief executive officer.

Stephen I. Chazen has served as a director since our formation in April 1999. Mr. Chazen served as a director of our predecessor from 1995 to April 1999. Mr. Chazen has served as executive vice president corporate development and chief financial officer of Occidental Petroleum Corporation since February 1999. From May 1994 to February 1999, he served as executive vice president corporate development of Occidental. From 1982 to April 1994, Mr. Chazen was an investment banker at Merrill Lynch & Co., Inc., where he was a managing director. He currently serves on the governance committees of Equistar Chemicals, LP and OxyVinyls, L.P.

Marshall A. Cohen has served as a director since our formation in April 1999. Mr. Cohen served as chairman of the board of directors from April 1999 to February 2002. Mr. Cohen has served as counsel at Cassels Brock & Blackwell LLP since October 1996. From November 1988 to September 1996, he served as president and chief executive officer of The Molson Companies Limited. Mr. Cohen also serves as a member of the board

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of directors of American International Group, Inc., Barrick Gold Corporation, Collins & Aikman Corporation, The Goldfarb Corporation, Golf Town Canada Inc., Haynes International, Inc., Lafarge Corporation, Metaldyne Corporation, SMK Speedy International Inc., and The Toronto-Dominion Bank.

David I. Foley has served as a director since our formation in April 1999. Mr. Foley is a principal at The Blackstone Group L.P., which he joined in 1995. Prior to joining Blackstone, Mr. Foley was an employee of AEA Investors Inc. from 1991 to 1993 and a consultant with The Monitor Company from 1989 to 1991. He currently serves on the board of directors of Mega Bloks Inc.

Robert L. Friedman has served as a director since July 1999. Mr. Friedman has served as a senior managing director of The Blackstone Group L.P. since February 1999. From 1974 until the time he joined Blackstone, Mr. Friedman was a partner with Simpson Thacher & Bartlett, a New York law firm. He currently also serves on the board of directors of American Axle & Manufacturing, Inc., Axis Capital Holdings Limited, Corp Group, Crowley Data LLC, Houghton Mifflin Holdings, Inc. and Northwest Airlines, Inc.

Richard C. Lappin has served as a director since October 1999. Mr. Lappin has served as a senior managing director of The Blackstone Group L.P. since February 1999. From 1989 to 1998, he served as president of Farley Industries, which included West Point-Pepperell, Inc., Acme Boot Company, Inc., Tool and Engineering, Inc., Magnus Metals, Inc. and Fruit of the Loom, Inc. Mr. Lappin currently also serves on the board of directors of American Axle & Manufacturing, Inc. and Haynes International, Inc. Fruit of the Loom, Inc. filed a petition seeking relief under Chapter 11 of the federal bankruptcy laws in December 1999.

Wilkes McClave III has served as a director since February 2002. From September 1982 to September 2001, Mr. McClave served in various positions with Tosco Corporation, most recently serving as Tosco s executive vice president and general counsel.

Henry M. Kuchta has served as our president since January 2003 and chief operating officer since April 2002. From April 2002 to December 2002, Mr. Kuchta served as executive vice president refining. Prior to this position he served as business development manager for Phillips 66 Company, since Phillips acquisition of Tosco Corporation in September 2001. Prior to joining Phillips, Mr. Kuchta served in various corporate, commercial and refining positions at Tosco from 1993 to 2001. Prior to joining Tosco, Mr. Kuchta spent 12 years at Exxon Corporation in various refining engineering and financial positions, including assignments overseas.

William E. Hantke has served as our executive vice president and chief financial officer since February 2002. From 1990 to January 2002, Mr. Hantke served in various positions with Tosco Corporation, most recently serving as Tosco s vice president of corporate development. He has held various finance and accounting positions in the oil industry and other commodity industries since 1975.

Dennis R. Eichholz has served as our senior vice president finance and controller since February 2001. Since joining us in 1988, Mr. Eichholz has held various financial positions, including vice president treasurer and director of tax. Prior to joining us, Mr. Eichholz held various corporate finance positions and began his career with Arthur Andersen & Co. in 1975.

Michael D. Gayda has served as our senior vice president, general counsel and secretary since October 2002. Prior to this position he served as general counsel refining for Phillips Petroleum Company, since Phillips acquisition of Tosco Corporation in September 2001. Prior to joining Phillips, from 1990 to 2001, Mr. Gayda served in various positions at Tosco Corporation, most recently serving as vice president and associate general counsel at Tosco Refining Company, a division of Tosco Corporation, from 1996 to 2001. Prior to joining Tosco, Mr. Gayda spent 11 years at Pacific Enterprises, predecessor of Sempra Energy, in various positions, including special counsel.

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James R. Voss has served as our senior vice president and chief administrative officer since September 2002. From December 2000 to September 2002, Mr. Voss served as our vice president and director of human resources. From June 1999 to December 2000, Mr. Voss served as the director of human resources for Swank Audio Visuals, Inc., a nationally recognized audio visual service provider, and from October 1996 to June 1999, he served as a human resource manager of Foodmaker, Inc., a $1 billion food distribution and restaurant company. Prior to joining Foodmaker, Inc., he spent 10 years in human resources management, operations and labor relations with United Parcel Service (UPS).

Joseph D. Watson has served as our senior vice president corporate development since September 2002. Mr. Watson served as our senior vice president and chief administrative officer from March 2002 to September 2002. He served as president of The e-Place.com, Ltd., a wholly owned subsidiary of Tosco Corporation, and a vice president of Tosco Shared Services from November 2000 to February 2002. He previously held various financial positions with Tosco from 1993 to 2000. From 1991 to 1993, he served as vice president of Argus Investments, Inc., a private investment company.

Gregory R. Bram has served as the refinery manager of our Lima refinery since October 1999. From 1996 to September 1999, Mr. Bram held several senior positions in our corporate office, including manager of planning and development and optimization manager. Prior to joining us, Mr. Bram held various engineering and operations positions with Amoco. Mr. Bram has more than 14 years of experience within the refining industry.

Donovan J. Kuenzli has served as the refinery manager of our Port Arthur refinery since October 1998. Prior to joining us, Mr. Kuenzli held various positions with BP, including refinery manager of the Lima refinery (then owned by BP), plant manager of a Texas chemicals facility, operations manager at BP s Alliance refinery and a corporate position in BP s London corporate office. Mr. Kuenzli has more than 40 years of experience within the refining and petrochemical industry.

Our board of directors is currently composed of the eight directors listed above, each of whom will serve until the next annual meeting of stockholders or until a successor is duly elected.

Committees of our Board of Directors

Our board of directors has formed three standing committees, an audit committee, a compensation committee and a committee on corporate governance.

Audit Committee. The principal duties of our audit committee are as follows:

- to assist the board of directors in fulfilling its oversight responsibilities by reviewing: the financial reports and other financial information we provide to any governmental body or the public; our systems of internal controls, established by management and the board of directors, regarding finance, accounting, legal compliance and ethics; and our auditing, accounting and financial reporting processes generally. Consistent with this function, the audit committee should encourage continuous improvement of, and should foster adherence to, our policies, procedures and practices at all levels;
- to serve as an independent and objective body to monitor our financial reporting process and internal control system;
- to review and appraise the audit efforts of our independent accountants and internal auditing department; and
- to provide an open avenue of communication among the independent accountants, financial and senior management, the internal auditing department, and the board of directors.

The members of the audit committee are Messrs. Allen (Chairman), Chazen and Cohen.

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Compensation Committee. The principal duties of our compensation committee are as follows:

to ensure our senior executives are compensated effectively in a manner consistent with our stated compensation strategy, internal equity considerations, competitive practice, and the requirements of the appropriate regulatory bodies; and

to communicate to shareholders our compensation policies and the reasoning behind such policies, as required by the Securities and Exchange Commission.

The members of the compensation committee are Messrs. Lappin (Chairman), Allen and Friedman.

Committee on Corporate Governance. The principal duties of our committee on corporate governance are as follows:

to recommend to the board of directors proposed nominees for election to the board of directors by the stockholders at annual meetings, including an annual review as to the renominations of incumbents and proposed nominees for election by the board of directors to fill vacancies which occur between stockholder meetings; and

to make recommendations to the board of directors regarding corporate governance matters and practices.

The members of the committee on corporate governance are Messrs. McClave (Chairman), Cohen and Foley.

Director Compensation

Our directors did not receive any compensation for their services as directors during 2001. In 1999, for his past and future services as a director, Mr. Cohen received a one-time grant of 65,656 shares of our common stock. He also received a one-time grant of an option to purchase 50,505 shares of our common stock at an exercise price of $9.90 per share, which was the fair market value on the date of grant. We also provide Mr. Cohen certain health care insurance coverage. All our directors are reimbursed for their out-of-pocket expenses. The directors of our company and our subsidiaries did not receive any compensation for their services as directors during 2001. See Directors and Executive Officers for additional information regarding our directors.

In February 2002, in consideration for Mr. Allen s future services as a director, we granted him options (with a three-year vesting schedule) to purchase 100,000 shares of our common stock at an exercise price equal to $10 per share. In connection with our IPO, Mr. Allen purchased 50,000 shares of our common stock at a price of $22.50 per share (the public offering price per share paid by the investors in the IPO, less the underwriting commission per share). We also granted Mr. Allen matching options (with a three-year vesting schedule) to purchase 50,000 shares of our common stock, at an exercise price of $22.50 per share.

In February 2002, in consideration for Mr. McClave s future services as a director, we granted him options (with a three-year vesting schedule) to purchase 100,000 shares of our common stock at an exercise price equal to $10 per share. In connection with the IPO, Mr. McClave purchased 50,000 shares of our common stock at a price of $22.50 per share (the public offering price per share paid by the investors in the IPO, less the underwriting commission per share). We also granted Mr. McClave matching options (with a three-year vesting schedule) to purchase 50,000 shares of our common stock, at an exercise price of $22.50 per share.

We adopted a compensation program for our non-employee directors consisting of an annual retainer of $50,000, board of directors and committee meeting fees of $1,000 per meeting, and an annual grant of options (with a five-year vesting schedule) to acquire 2,500 shares of our common stock at the then fair market value. In addition, non-employee board and committee chairpersons receive an additional retainer of $10,000 per year. Director compensation for Messrs. Foley, Friedman and Lappin is paid directly to Blackstone. Director compensation for Mr. Chazen is paid directly to Occidental.

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Compensation Committee Interlocks and Insider Participation

The following individuals served as members of our compensation committee during 2001: Messrs. Lappin (chairman), Cohen and Friedman. None of the compensation committee members is, or at any time has been, officers or employees of us or any of its subsidiaries. Messrs. Friedman and Lappin are members of Blackstone. See Principal Stockholders and Related Party Transactions for additional information regarding the relationship between us and Blackstone.

Executive Compensation

The following table sets forth the annual compensation for our former chief executive officer, former chief financial officer, former general counsel and our two other most highly compensated executive officers for their services to our company during the fiscal years 2001, 2000 and 1999. For information about the future compensation for each of Messrs. O Malley, Kuchta, Hantke, Gayda, Voss and Watson, see Executive Officer Benefits and Agreements Employment Agreement with Thomas D. O Malley, Employment Agreement with Henry M. Kuchta, Employment Agreement with William E. Hantke, Employment Agreement with Michael D. Gayda, Employment Agreement with James R. Voss and Employment Agreement with Joseph D. Watson.

Summary Compensation Table

	Annual Compensation				
Name and Principal Position	**Fiscal Year**	**Salary ($)**	**Bonus ($)**	**Other ($) (4)**	**All Other Compensation ($) (5)**
William C. Rusnack (1)	2001	497,693	746,800	18,679	10,200
Former President, Chief Executive Officer and Chief Operating	2000	477,694	610,000		10,200
Officer	1999	454,808	370,000	1,535	9,600
Ezra C. Hunt (2)	2001	317,309	378,000	45,980	344,739
Former Executive Vice President and Chief Financial Officer					
Jeffry N. Quinn (3)	2001	297,981	344,500	13,901	10,200
Former Executive Vice President and General Counsel	2000	236,867	232,000		130,215
Donovan J. Kuenzli	2001	223,732	202,600	9,573	10,200
Refinery Manager, Port Arthur Refinery	2000	212,846	200,000	400	10,200
	1999	203,538	80,000	45,392	9,600
Dennis R. Eichholz	2001	167,693	151,500	31,125	9,928
Senior Vice President Finance and Controller	2000	148,443	100,000	7,875	9,033
	1999	136,038	62,502	7,875	8,635

(1) Mr. Rusnack resigned in January 2002. See Executive Officer Benefits and Agreements Termination Agreement with William C. Rusnack for a discussion of the terms of Mr. Rusnack s termination agreement with us.

(2) Mr. Hunt resigned in January 2002. Mr. Hunt joined us in February 2001 as our executive vice president and chief financial officer. We therefore do not have compensation to disclose for Mr. Hunt for years prior to 2001. See Executive Officer Benefits and Agreements Termination Agreement with Ezra C. Hunt for a discussion of the terms of Mr. Hunt s termination agreement with us.

(3) Mr. Quinn resigned in November 2002. See Executive Officer Benefits and Agreements Separation Agreement with Jeffry N. Quinn for a discussion of the terms of Mr. Quinn s separation agreement with us.

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(4) Represents (i) amounts for financial planning services for Messrs. Rusnack, Quinn and Eichholz, amounts for unused vacation for Messrs. Kuenzli and Eichholz, an amount for a safety award for Mr. Kuenzli and relocation expenses for Mr. Hunt for 2001, (ii) an amount for a safety award for Mr. Kuenzli and an amount for unused vacation for Mr. Eichholz for 2000 and (iii) amounts for relocation expenses for Messrs. Rusnack and Kuenzli and amounts for unused vacation for Messrs. Kuenzli and Eichholz for 1999.

(5) Represents (i) amounts accrued for the account of such individuals under the Premcor Retirement Savings Plan for 2001, as well as a starting bonus of $336,950 paid to Mr. Hunt upon his joining us in February 2001, (ii) amounts accrued for the account of such individuals under the Premcor Retirement Savings Plan for 2000, as well as a starting bonus of $125,000 paid to Mr. Quinn upon his joining us in March 2000 and (iii) amounts accrued for the account of such individuals under the Premcor Retirement Savings Plan and the Supplemental Savings Plan for 1999.

Stock Option Grants

The following table sets forth information concerning grants of each of time vesting and performance vesting stock options to purchase our common stock made during the year ended December 31, 2001, to each of the named executive officers.

Option Grants in Last Fiscal Year

	Individual Grants(1)				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation For Option Term	
	Number of Securities Underlying Options Granted(#)	% of Total Options Granted To Employees In Fiscal Year	Exercise or Base Price ($/Share)	Expiration Date	5%	10%
Ezra C. Hunt (2)	120,000	60%	9.90	November 9, 2002	$ 13,308	$ 26,831
Dennis R. Eichholz (3)	30,000	15	9.90	September 30, 2008	13,297	157,428
Donovan J. Kuenzli (4)	20,000	10	9.90	September 30, 2008	8,865	104,952

(1) All options are options to purchase shares of our common stock. All options were granted pursuant to Premcor Inc. s 1999 Stock Incentive Plan. The options are exercisable at a price of $9.90 per share, which was the fair market value at the date of grant.

(2) On February 26, 2001, we granted Mr. Hunt 60,000 time vesting options and 60,000 performance vesting options. Of the 120,000 options granted, 20,000 time vesting options vested upon Mr. Hunt s termination of employment on January 31, 2002 and the remainder were forfeited. Mr. Hunt has exercised the 20,000 options.

(3) All 30,000 options granted to Mr. Eichholz are performance vesting options. The options vest seven years from the date of grant, with vesting being accelerated upon the achievement of certain targeted stock prices or a change in control transaction. Of the 30,000 options, 15,000 are currently vested. The date of Mr. Eichholz s grant was March 2, 2001.

(4) All 20,000 options granted to Mr. Kuenzli are performance vesting options. The options vest seven years from the date of grant, with vesting being accelerated upon the achievement of certain targeted stock prices or a change in control transaction. Of the 20,000 options, 10,000 are currently vested. The date of Mr. Kuenzli s grant was March 2, 2001.

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Exercises of Stock Options

The following table shows aggregate exercises of options to purchase our common stock and the number and value of securities underlying unexercised stock options held by the named executive officers as of December 31, 2001.

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Securities Underlying Unexercised Options At Fiscal Year-End (#)		Value of Unexercised In-The-Money Options At Fiscal Year-End ($)	
			Exercisable	Unexercisable	Exercisable	Unexercisable
William C. Rusnack (1)	0	0	300,000	300,000	0	0
Ezra C. Hunt (1)	0	0	0	120,000	0	0
Jeffry N. Quinn (1)	0	0	15,000	105,000	0	0
Donovan J. Kuenzli	0	0	0	80,000	0	0
Dennis R. Eichholz	0	0	20,000	40,000	0	0

(1) For a discussion of what impact, if any, Mr. Rusnack s, Mr. Hunt s and Mr. Quinn s terminations of employment had on their outstanding options, see Executive Officer Benefits and Agreements Termination Agreement with William C. Rusnack, and Termination Agreement with Ezra C. Hunt and Separation Agreement with Jeffry N. Quinn.

Compensation Principles

Our compensation program for executive officers is designed to attract, retain and motivate these officers to enhance long-term stockholder value. The program consists of the following three key elements:

- a base salary;
- a performance-based annual bonus; and
- long-term equity incentive programs.

Our compensation philosophy:

- targets base pay at median levels of an appropriate comparator group with total compensation in line with relative performance;
- emphasizes variable, incentive-oriented pay that rewards executives for achievement of predetermined operating and financial objectives;
- places increased emphasis on variable pay and long-term incentives at higher levels in the organization;
- balances the focus on short-term and long-term performance; and
- utilizes plans which are fair and understandable so that the plans drive performance and do not simply follow performance.

Short-Term Performance

Annual Base Salary

Annual salary is designed to compensate our executive officers for enhancing earnings per share and the creation of shareholder value. Salaries for the executive officers and certain other officers who report directly to the chief executive officer are established on an annual basis by the compensation committee, typically at the first committee meeting of the year. Individual and/or corporate performance is considered in determining salary amounts.

Annual Incentive Bonus for Calendar Year 2001

We have adopted the Premcor Executive Recognition Plan which provides key salaried employees, or participants, the opportunity to receive annual bonuses based upon the achievement of operating, financial and/or individual performance goals. In calendar year 2001, a total of 149 salaried employees participated in the Executive Recognition Plan, including the named executive officers. Under the Executive Recognition Plan each participant has a target bonus, which is expressed as a fixed percentage of base pay. The 2001 target bonus opportunity was 150% of annual base pay for Mr. Rusnack, 100% of annual base pay for Mr. Hunt and Mr. Quinn and 75% of annual base pay for the other named executive officers.

For 2001, target bonus opportunities were divided into two components, an objective performance component and a personal performance component. Objective performance measures constituted 70% of the bonus opportunity of Messrs. Rusnack, Hunt and Quinn and 60% for the other named executive officers. The remaining portion of their bonus opportunities was based upon personal performance.

In determining annual bonuses for 2001, the objective performance component was measured by a weighting of the following three performance measures: cash flow; costs, which for such purpose means operating expenses, excluding energy costs, plus general and administrative expenses; and a measure of gross margin which utilizes a constant price set and constant energy cost, referred to as the Premcor Value Index. Refinery participants, including corporate direct reports located at the refineries, had a significant portion of their objective award tied to the performance of the refinery. Objective awards of the corporate participants were tied to the performance of our company.

Annual Bonuses for Calendar Year 2002

In February 2002, the Premcor Executive Recognition Plan was renamed the Premcor Incentive Compensation Plan and was expanded to include all of our salaried employees, except for Messrs. O Malley, Kuchta, Hantke, Gayda, Voss and Watson whose bonus terms are provided in their employment agreements with us. For 2002, bonus awards for participants will be earned solely on the basis of our achievement of earnings per share results. The earnings per share measure has a threshold, target and maximum performance level and a corresponding payout level. For participants in the plan, the threshold performance level is earnings per share of $2.00, the target performance level is earnings per share of $3.50 and the maximum performance level is earnings per share of $5.00. The maximum bonus opportunity for participants is equal to 200% of annual base pay. For information regarding bonus award opportunities for each of Messrs. O Malley, Kuchta, Hantke, Gayda, Voss and Watson, see Executive Officer Benefits and Agreements Employment Agreement with Thomas D. O Malley, Employment Agreement with Henry M. Kuchta, Employment Agreement with William E. Hantke, Employment Agreement with Michael D. Gayda, Employment Agreement with James R. Voss and Employment Agreement with Joseph D. Watson.

Long-Term Performance

2002 Special Stock Incentive Plan

In connection with the employment of Mr. Thomas D. O Malley, we established a 2002 Special Stock Incentive Plan for Mr. O Malley (the Special Plan).

Eligibility. Mr. O Malley is eligible for the grant of options to purchase shares of our common stock under the Special Plan.

Shares Reserved for Awards and Shares Outstanding. The number of shares of our common stock that may be issued or delivered under the Special Plan for stock options granted during the term of the Special Plan is 3,400,000 shares. As of December 31, 2002, we granted Mr. O Malley 2,200,000 stock options at an exercise price of $10 per share and, in connection with the IPO, 750,000 stock options at an exercise price of $22.50 per share (the public offering price per share paid by the investors in the IPO, less the underwriting commission per share). In addition, pursuant to the terms of Mr. O Malley s employment agreement we have committed to grant him 150,000 options a year during 2003 through 2005 at an exercise price equal to the fair market value on the date of the grant. See Executive Officer Benefits and Agreements Employment Agreement with Thomas D. O Malley.

Administration. Our board of directors administers the Special Plan, and has full and exclusive power to grant waivers of stock option restrictions and to adopt such rules, regulations and guidelines for carrying out the Special Plan and such modifications, amendments, procedures, and the like as are necessary or proper to comply with provisions of the laws and regulations of the jurisdictions in which we operate in order to assure the viability of stock options granted under the Special Plan and to enable Mr. O Malley, regardless of where employed, to receive advantages and benefits under the Special Plan and such laws and regulations. In general, our board of directors may delegate their authority to administer the Special Plan to the compensation committee of our board of directors (if any) or such other committee as may be designated by our board of directors to administer the Special Plan; provided, however, that the committee shall satisfy the qualifications set forth in the Special Plan.

Stock Options. Our board of directors determines the stock options to be awarded to Mr. O Malley and shall set forth in the related stock option award certificate the terms, conditions, requirements and limitations applicable to such stock option. No stock option shall be exercisable more than ten years after the date of its grant. Nothing contained in the Special Plan or any stock option award certificate shall confer, and no grant of a stock option shall be construed as conferring, upon Mr. O Malley any right to continue in our employ or to interfere in any way with our right to terminate Mr. O Malley s employment at any time or increase or decrease Mr. O Malley s compensation from the rate in existence at the time of granting of a stock option. No stock option shall confer on Mr. O Malley any of the rights of a shareholder of us unless and until shares of our common stock are duly issued or transferred to Mr. O Malley in accordance with the terms of the stock option.

The price at which shares of our common stock may be purchased under a stock option is determined by our board of directors and evidenced in the stock option award certificate, and shall be paid by Mr. O Malley in full at the time of the exercise in cash or, to the extent permitted by the committee, in shares of our common stock having a fair market value equal to the aggregate exercise price under the stock option for the shares of our common stock being purchased, so long as such shares of our common stock have been held by Mr. O Malley for no less than six months (or such other period as established from time to time by the committee or GAAP).

Termination of Employment. If Mr. O Malley s employment is terminated, all stock options and stock option shares held by him shall be governed by, and shall be subject to, the terms and conditions set forth in this plan, in any stock option award certificate and in his employment agreement.

Nonassignability. Unless otherwise provided by our board of directors, no stock option shall be assignable or transferable, or payable to or exercisable by anyone other than Mr. O Malley (other than upon death or disability).

Adjustment and Change in Control. In the event of any change in the outstanding shares of our common stock by reason of any stock dividend or split, reorganization, recapitalization, merger, consolidation, spin-off, combination or exchange of shares of our common stock or other corporate exchange, or any distribution to shareholders of our common stock other than regular cash dividends, our board of directors will make such equitable substitutions or adjustments, if any, as are necessary as to the number or kind of shares of our common stock or other securities issued or reserved for issuance pursuant to the Special Plan or pursuant to outstanding stock options, the stock option price and/or any other affected terms of such stock options.

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In the event of a change in control (as defined in the Special Plan), our board of directors will take such actions, if any, as it in good faith deems equitable with respect to any stock option (including, without limitation, the acceleration of the stock option, the payment of cash equal to the excess of the per share consideration received by the holders of shares of our common stock in the change in control, in exchange for the cancellation of the stock option and/or the requiring of the issuance of substitute stock options that will substantially preserve the value, rights and benefits of any affected stock options previously granted under the Special Plan) effective upon the date of the consummation of the change in control.

Amendment. Our board of directors may amend the Special Plan without the consent of shareholders or Mr. O Malley to the extent necessary to comply with any federal or state law or regulation or the rules of any stock exchange on which the shares of our common stock may be listed. Our board of directors may waive any conditions or rights under, or amend, alter, accelerate, suspend, discontinue or terminate, any stock option theretofore granted and any stock option award certificate relating thereto; provided, however, that, without the consent of Mr. O Malley, no such amendment, alteration, suspension, discontinuation or termination of any stock option may impair his rights under such stock option.

Legal Requirements. The Special Plan, the granting and exercising of stock options thereunder and the other obligations under the Special Plan shall be subject to all applicable federal and state laws, rules and regulations. It is our intention that any stock option granted to a person who is subject to Section 16 of the 1934 Act qualifies for exemption under Rule 16b-3.

2002 Equity Incentive Plan

Our board of directors has adopted the Premcor 2002 Equity Incentive Plan which is designed to permit us to grant to our key employees, directors and consultants incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock, performance-based awards and other awards based on common stock, in each case in respect of our common stock.

Administration. Our compensation committee administers the 2002 Equity Incentive Plan. The committee determines who will receive awards under the 2002 Equity Incentive Plan, as well as the form of the awards, the number of shares underlying the awards, and the terms and conditions of the awards consistent with the terms of the plan. The committee may delegate its authority under the 2002 Equity Incentive Plan in whole or in part as it determines, including to a subcommittee consisting solely of at least two outside directors within the meaning of Rule 16b-3 of the Securities Exchange Act of 1934, as amended (the Exchange Act).

Shares Reserved for Awards, Limits on Awards and Shares Outstanding. The total number of shares of our common stock initially available for issuance or delivery under the 2002 Equity Incentive Plan is 1,500,000 shares. As of December 31, 2002, there were 998,500 stock options outstanding under the plan. We have committed to granting options to purchase an aggregate of 365,000 shares of our common stock to certain officers during the period 2003 through 2005 at an exercise price equal to the fair market value of a share of our common stock on the date of the grant. All options granted as of December 31, 2002 and those options to be granted during 2003 through 2005 will vest in equal installments on each of the first three anniversaries of the date of grant.

The number of shares of our common stock issued or reserved pursuant to the 2002 Equity Incentive Plan and the number of shares issuable pursuant to outstanding awards are subject, at the compensation committee s discretion, to adjustment as a result of stock splits, stock dividends and other dilutive changes in our common stock. Common stock covered by awards that terminate, lapse, or are cancelled will again be available for the grant of awards under the 2002 Equity Incentive Plan.

Stock Options. The 2002 Equity Incentive Plan permits the committee to grant participants incentive stock options, which qualify for special tax treatment in the United States, as well as nonqualified stock options. The

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committee establishes the duration of each option at the time it is granted, with a maximum ten-year duration for incentive stock options. The committee may establish vesting and performance requirements that must be met prior to the exercise of options.

Stock option grants may include provisions that permit the option holder to exercise all or part of the holder s vested options, or to satisfy withholding tax liabilities, by tendering shares of common stock already owned by the option holder for at least six months (or another period consistent with the applicable accounting rules) with a fair market value equal to the exercise price. Stock option grants may also include provisions that permit the option holder to exercise all or part of the holder s vested options through an exercise procedure, which requires the delivery of irrevocable instructions to a broker to sell the shares obtained upon exercise of the option and deliver promptly to us the proceeds of the sale equal to the aggregate exercise price of the common stock being purchased.

Stock Appreciation Rights. The committee may also grant stock appreciation rights, either alone or in tandem with underlying stock options, as well as limited stock appreciation rights, which are exercisable upon the occurrence of certain contingent events. Stock appreciation rights entitle the holder upon exercise to receive an amount in any combination of cash or shares of our common stock (as determined by the committee) equal in value to the excess of the fair market value of the shares covered by the right over the grant price.

Other Stock-Based Awards. The 2002 Equity Incentive Plan permits the committee to grant awards that are valued by reference to, or otherwise based on, the fair market value of our common stock. These awards will be in such form and subject to such conditions as the committee may determine, including the satisfaction of performance goals, the completion of periods of service or the occurrence of certain events.

Change-in-Control Provisions. The committee may, in the event of a change in control, provide that any outstanding awards that are unexercisable or otherwise unvested will become fully vested and immediately exercisable. In addition, the committee may, in its sole discretion, provide for the termination of an award upon the consummation of the change in control and the payment of a cash amount in exchange for the cancellation of an award, and/or the issuance of substitute awards that will substantially preserve the otherwise applicable terms of any affected award.

Amendment and Termination. Our board of directors may amend or terminate the 2002 Equity Incentive Plan at any time, provided that no amendment or termination will be made that increases the number of shares available for awards under the 2002 Equity Incentive Plan or diminishes the rights of the holder of any award. Our board of directors may amend the plan in such manner as it deems necessary to permit awards to meet the requirements of applicable laws.

1999 Stock Incentive Plan

Our board of directors has adopted the Premcor 1999 Stock Incentive Plan, or the 1999 Incentive Plan, which is designed to attract and retain executive officers and other selected employees whose skills and talents are important to our company. Under the 1999 Incentive Plan, our executive officers and other employees are eligible to receive awards of options to purchase shares of our common stock.

The compensation committee of our board of directors administers the 1999 Incentive Plan. Subject to the provisions of the 1999 Incentive Plan, the committee is authorized to determine who may participate in the plan, the number and types of awards made to each participant, and the terms, conditions, requirements, and limitations applicable to each award. Awards may be granted singularly or in combination. Awards may also be made in combination or in tandem with, in replacement of, or as alternatives to, grants or rights under any other employee plan of our company, including the plan of any acquired entity. Subject to certain limitations, our board of directors is authorized to amend, modify or terminate the 1999 Incentive Plan.

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Options granted under the 1999 Incentive Plan to executive officers and other employees are either time vesting or performance vesting options. The time vesting options vest in one of the two following manners: (i) 50% at the date of grant and 25% on each January 1st thereafter, or (ii) 1/3 on the first, second, and third anniversaries of the date of grant. The performance vesting options fully vest on the seventh anniversary of the date of grant, provided, however, that following our IPO in May 2002 or upon a change in control of our company, the vesting is accelerated based on the achievement of certain per share prices of the common stock. The accelerated vesting schedule is as follows:

Average closing price per share of capital stock for any 180 consecutive days; or change in control price	% of shares with respect to which option is exercisable
Below $12.00	0%
$12.00-$14.99	10
$15.00-$17.99	20
$18.00-$19.99	30
$20.00-$24.99	50
$25.00-$29.99	75
Above $29.99	100

As of December 31, 2002, 50% of the performance vesting options granted under the plan had vested.

In the event of a change in control of our company, our board of directors may, with respect to any option award, take actions that cause: the acceleration of the award; the payment of a cash amount in exchange for the cancellation of the award; and/or the issuance of substitute awards that will substantially preserve the value, rights and benefits of any affected awards.

Options in an aggregate amount of 2,215,250 shares of our common stock are reserved for issuance under the 1999 Incentive Plan. The current aggregate amount of stock underlying option awards is, at the board of directors discretion, subject to a stock dividend or split, reorganization, recapitalization, merger, consolidation, spin-off, combination or exchange of stock. As of December 31, 2002, 527,975 stock options were outstanding at an exercise price of $9.90 per share and 62,500 stock options were outstanding at an exercise price of $15 per share. All options were granted at an exercise price equal to the fair market value of our common stock as of the date of grant. All options expire no more than ten years after the date of grant.

In addition, in the event of any termination of employment of a participant, we have the right, for a certain period of time and under certain conditions following such termination of employment, to purchase all of the participant s exercisable stock options at a price equal to the net stock option value, which is the fair market value of the underlying shares less the exercise price, and any shares of our common stock acquired by the participant pursuant to the participant s exercise of any stock option, generally at a price equal to the fair market value of our common stock, although upon a termination for cause by us, all of the participant s options terminate immediately without payment and we can purchase, for a period of 30 days following such termination, all of the participant s shares of common stock at a price per share equal to the lower of its fair market value or the exercise price.

Phantom Performance Shares

In 2000, the compensation committee of our board of directors adopted a Long Term Incentive Plan which was designed to provide certain key management employees of our company the opportunity to receive grants of performance units or awards, the value of which is measured based on the performance of our common stock. This plan was designed to reward participants for achieving pre-defined operating and financial performance goals over a three-year performance cycle. The first three-year performance cycle under the plan began on January 1, 2001. For such performance period, 87,300 performance units are currently outstanding.

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Messrs. Eichholz and Kuenzli were the only named executive officers to participate in the plan for that performance cycle. Our board of directors terminated the Long Term Incentive Plan in February 2002. As a result there will be no future grants under the plan.

Executive Officer Agreements

Employment Agreement with Thomas D. O Malley

We entered into an employment agreement with Thomas D. O Malley, dated January 30, 2002, and which was subsequently amended, pursuant to which Mr. O Malley agreed to serve as our full-time chairman of the board of directors and as our chief executive officer and president. The agreement has a term of three years but is subject to automatic one-year extensions thereafter, unless either party gives the other 60 days prior written notice of its intention not to extend the term. The agreement provides for an annual base salary (with increases, if any, to be determined by our board of directors) of $500,000 (which Mr. O Malley has voluntarily agreed to reduce to $300,000 until he reinstates the previous amount by providing 30 days notice to us). In addition, the employment agreement provides that Mr. O Malley will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and in accordance with GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, is at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. O Malley shall equal his unreduced base salary (his base bonus). Mr. O Malley shall have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of six times his unreduced base salary. Pursuant to the employment agreement, Mr. O Malley purchased 750,000 shares of our common stock issued in the IPO at a price of $22.50 per share (the public offering price per share paid by the investors in the IPO, less the underwriting commission per share). The employment agreement also provides that Mr. O Malley will be granted (i) upon execution of the agreement, an initial option to purchase 2,200,000 shares of our common stock at an exercise price equal to $10 per share under the Special Plan; (ii) matching options to purchase the same number of shares of our common stock he purchases (as described above) at an exercise price equal to the purchase price per share paid for the shares he purchases (as described above) under the Special Plan; and (iii) annual options to purchase 150,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant, in each of the years 2003, 2004 and 2005, all under the Special Plan. Mr. O Malley has agreed to customary transfer limitations, tag-along rights, drag-along rights and rights of first refusal with respect to any shares he acquires pursuant to the prior sentence (including any shares acquired by means of a stock split, stock dividend or distribution affecting the shares acquired pursuant to the prior sentence). Pursuant to the employment agreement, if Mr. O Malley s employment is terminated by us without cause, by Mr. O Malley for good reason or upon our election not to extend the employment term, Mr. O Malley will be entitled to receive (i) any accrued but unpaid base salary and annual bonus, (ii) subject to Mr. O Malley s continued compliance with non-competition, non-solicitation, no-hire and confidentiality covenants, three times the sum of Mr. O Malley s unreduced base salary plus base bonus, (iii) the accrued retirement benefit, whether or not vested, and (iv) full vesting of any outstanding stock options. Mr. O Malley is also entitled to be grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Employment Agreement with Henry M. Kuchta

We entered into an amended and restated employment agreement with Henry M. Kuchta, dated as of June 1, 2002, and which was subsequently amended, pursuant to which Mr. Kuchta agreed to serve as executive vice president-refining. Mr. Kuchta was appointed president effective January 1, 2003. The agreement has a term of two years but is subject to automatic one-year extensions thereafter, unless either party gives the other 60 days prior written notice of its intention not to extend the term. The agreement provides for an annual base salary (with increases, if any, to be determined by our board of directors) of $250,000. In addition, the employment

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agreement provides that Mr. Kuchta will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and according to GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, are at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. Kuchta shall be equal to 50% of his annual base salary (his base bonus). Mr. Kuchta will have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of three times his base salary. Pursuant to the 2002 Equity Incentive Plan, Mr. Kuchta will receive annual options to purchase at least 25,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant in each of the years 2003 and 2004. Pursuant to the employment agreement, if Mr. Kuchta s employment is terminated by us without cause, by Mr. Kuchta for good reason or upon our election not to extend the employment term, Mr. Kuchta will be entitled to receive (i) any accrued but unpaid base salary plus base bonus attributable to a prior fiscal year and (ii) subject to Mr. Kuchta s continued compliance with non-competition, non-solicitation, no-hire and confidentiality covenants, three times the sum of Mr. Kuchta s base salary plus base bonus. Mr. Kuchta is also entitled to be grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Employment Agreement with William E. Hantke

We entered into an amended and restated employment agreement with William E. Hantke, dated as of June 1, 2002, and which was subsequently amended, pursuant to which Mr. Hantke agreed to serve as our executive vice president and chief financial officer. The agreement has a term of three years but is subject to automatic one-year extensions thereafter, unless either party gives the other 60 days prior written notice of its intention not to extend the term. The agreement provides for an annual base salary (with increases, if any, to be determined by our board of directors) of $250,000. In addition, the employment agreement provides that Mr. Hantke will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and according to GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, is at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. Hantke shall be equal to 50% of his annual base salary (his base bonus). Mr. Hantke shall have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of three times his base salary. The employment agreement also provides that Mr. Hantke will be granted annual options to purchase 25,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant, in each of the years 2003, 2004 and 2005, all under the 2002 Equity Incentive Plan. Pursuant to the employment agreement, if Mr. Hantke s employment is terminated by us without cause, by Mr. Hantke for good reason or upon our election not to extend the employment term, Mr. Hantke will be entitled to receive (i) any accrued but unpaid base salary and annual bonus attributable to a prior fiscal year and (ii) subject to Mr. Hantke s continued compliance with non-competition, non-solicitation, no-hire and confidentiality covenants, three times the sum of Mr. Hantke s base salary plus base bonus. Mr. Hantke is also entitled to be grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Employment Agreement with Michael D. Gayda

We entered into an employment agreement with Michael D. Gayda, dated as of October 1, 2002, and which was subsequently amended, pursuant to which Mr. Gayda agreed to serve as senior vice president, general counsel and secretary. The agreement has an initial term of two years but is subject to automatic one-year extensions thereafter, unless either party gives the other 60 days prior written notice of its intention not to extend the term. The agreement provides for an annual base salary (with increases, if any, to be determined by our board of directors) of $200,000. In addition, the employment agreement provides that Mr. Gayda will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and according to GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, is at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. Gayda shall be equal to 50% of his annual base salary (his base bonus). Mr. Gayda shall have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of three times his base salary. The employment agreement also provides that Mr. Gayda will be granted annual options to purchase not less than 25,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant, in each of the years 2003, 2004 and 2005, all under the 2002 Equity Incentive Plan. Pursuant to the employment agreement, if Mr. Gayda s employment is terminated by us. without cause, by Mr. Gayda for good reason or upon our election not to extend the employment term, Mr. Gayda will be entitled to receive (i) any accrued but unpaid base salary and annual bonus attributable to a prior fiscal year and (ii) subject to Mr. Gayda s continued compliance with confidentiality covenants, three times the sum of Mr. Gayda s base salary plus base bonus. Mr. Gayda is also entitled to have his salary grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Employment Agreement with James R. Voss

We entered into an employment agreement with James R. Voss, dated as of September 16, 2002, and which was subsequently amended, pursuant to which Mr. Voss agreed to serve as senior vice president and chief administrative officer. The agreement has an initial term of two years but is subject to automatic one-year extensions thereafter, unless either party gives the other 60 days prior written notice of its intention not to extend the term. The agreement provides for an annual base salary (with increases, if any, to be determined by our board of directors) of $200,000. In addition, the employment agreement provides that Mr. Voss will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and according to GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, is at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. Voss shall be equal to 50% of his annual base salary (his base bonus). Mr. Voss shall have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of three times his base salary. The employment agreement also provides that Mr. Voss will be granted annual options to purchase not less than 25,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant, in each of the years 2003, 2004 and 2005, all under the 2002 Equity Incentive Plan. Pursuant to the employment agreement, if Mr. Voss s employment is terminated by us without cause, by Mr. Voss for good reason or upon our election not to extend the employment term, Mr. Voss will be entitled to receive (i) any accrued but unpaid base salary and annual bonus attributable to a prior fiscal year and (ii) subject to Mr. Voss s continued compliance with confidentiality covenants, three times the sum of Mr. Voss s base salary plus base bonus. Mr. Voss is also entitled to have his salary grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Employment Agreement with Joseph D. Watson

We entered into an amended and restated employment agreement with Joseph D. Watson, dated June 1, 2002, and which was subsequently amended, pursuant to which Mr. Watson agreed to serve as senior vice president. The agreement has a term of two years but is subject to automatic one-year extensions thereafter, unless either party gives the other sixty days prior written notice of its intention not to extend the term. The agreement provides for

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an annual base salary (with increases, if any, to be determined by our board of directors) of $200,000. In addition, the employment agreement provides that Mr. Watson will be eligible to earn an annual bonus if net earnings per share to our common shareholders, calculated on a fully diluted basis and according to GAAP, excluding the after-tax impact of any extraordinary or special items that our board of directors determines in good faith are not appropriately includable in such calculation because such items do not accurately reflect our operating performance, is at least equal to $2.00. Upon achievement of such $2.00 earnings per share, the annual bonus for Mr. Watson shall be equal to 50% of his annual base salary (his base bonus). Mr. Watson shall have an opportunity to earn a larger bonus for increases in such earnings per share over $2.00, subject to a cap of three times his base salary. The employment agreement also provides that Mr. Watson will be granted annual options to purchase 25,000 shares of our common stock per year at an exercise price equal to fair market value on the date of grant, in each of the years 2003 and 2004, all under the 2002 Equity Incentive Plan. Pursuant to the employment agreement, if Mr. Watson s employment is terminated by us without cause, by Mr. Watson for good reason or upon our election not to extend the employment term, Mr. Watson will be entitled to receive (i) any accrued but unpaid base salary and annual bonus attributable to a prior fiscal year and (ii) subject to Mr. Watson s continued compliance with non-competition, non-solicitation, no-hire and confidentiality covenants, three times the sum of Mr. Watson s base salary plus base bonus. Mr. Watson is also entitled to have his salary grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he receives in connection with benefits and payments provided to him in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Termination Agreement with William C. Rusnack

William C. Rusnack served as the chief executive officer and president from April 1998 to January 31, 2002. On January 31, 2002, we entered into a termination agreement with Mr. Rusnack pursuant to which he resigned from all executive officer and board positions with us and our affiliates. Mr. Rusnack agreed to release us and our affiliates from any claims he may have against us and our affiliates, and we agreed to provide certain severance payments and benefits. Upon the termination of his employment, Mr. Rusnack received a lump sum severance payment of $3,375,000. All 300,000 nonqualified time vesting stock options to purchase shares of our common stock that had been granted to Mr. Rusnack under the 1999 Incentive Plan had vested prior to his termination. However, Mr. Rusnack s exercise period was modified such that he was entitled to exercise his vested options until November 9, 2002. Fifty percent of the 300,000 performance vesting options granted to Mr. Rusnack under the 1999 Incentive Plan vested prior to the November 9th expiration date and the remaining fifty percent expired. Mr. Rusnack has exercised all 450,000 vested options. For more detail on Mr. Rusnack s stock options, see Long-Term Performance 1999 Stock Incentive Plan. Mr. Rusnack is entitled to receive job relocation counseling services for up to 18 months and continued participation for up to one year in all life insurance and welfare programs in which he participated immediately prior to his termination. Mr. Rusnack is also entitled to have his salary grossed up, on an after-tax basis, for excise taxes imposed under the Internal Revenue Code on any excess parachute payment as set forth in his original employment agreement. Mr. Rusnack has agreed to certain post-termination confidentiality covenants.

Termination Agreement with Ezra C. Hunt

Mr. Hunt served as executive vice president and chief financial officer from February 26, 2001 to January 31, 2002. On January 31, 2002, we entered into a termination agreement with Mr. Hunt, pursuant to which he resigned from his executive officer positions. Mr. Hunt agreed to release us and our affiliates from any claims he may have against us and our affiliates, and we agreed to provide certain severance payments and benefits. Under the agreement, Mr. Hunt is entitled to $1,500,000 (less the present value of any other termination benefits payable by us) which is equal to two times the sum of his base salary and target bonus, such amount being payable over a 24-month period. Of the 120,000 nonqualified stock options to purchase shares of our common stock granted to Mr. Hunt under the 1999 Incentive Plan, 20,000 options vested upon his termination and the remainder were forfeited. However, Mr. Hunt s exercise period was modified such that he was entitled to exercise his vested options until November 9, 2002. Mr. Hunt has exercised his 20,000 vested options. Mr. Hunt

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is entitled to receive job relocation counseling services for up to 18 months and continued participation for up to one year in all life insurance and welfare programs in which he was entitled to participate immediately prior to his termination. Mr. Hunt is also entitled to have his salary grossed up, on an after-tax basis, for excise taxes imposed under the Internal Revenue Code on any excess parachute payment as set forth in his original employment agreement. Mr. Hunt has agreed to certain post-termination confidentiality covenants.

Separation Agreement with Jeffry N. Quinn

Mr. Quinn served as executive vice president and general counsel from March 2000 to November 1, 2002. On November 1, 2002, we entered into a separation agreement with Mr. Quinn, pursuant to which he resigned from all executive officer and board positions with us and our affiliates. Mr. Quinn agreed to release us and our affiliates from any claims he may have against us and our affiliates, and we agreed to provide certain severance payments and benefits. Under the agreement, on January 2, 2003, Mr. Quinn will receive a lump sum severance payment of $1,165,000. Of the 120,000 nonqualified stock options granted to Mr. Quinn under the 1999 Incentive Plan, 90,000 options were vested as of his termination date or vested upon his termination. As of December 1, 2002, Mr. Quinn had exercised 45,000 of these options. Mr. Quinn is entitled to exercise the remaining vested options until March 1, 2004. All of the 50,000 nonqualified stock options granted to Mr. Quinn under the 2002 Equity Incentive Plan were forfeited upon his termination. Mr. Quinn is entitled to receive job relocation counseling services up to $35,000. He is also entitled to have his salary grossed up, on an after-tax basis, for excise taxes imposed under the Internal Revenue Code on any excess parachute payment as set forth in his original employment agreement. Mr. Quinn has agreed to certain post-termination confidentiality covenants.

Other Employee Benefits

Senior Executive Retirement Plan

We adopted a Senior Executive Retirement Plan (SERP) covering seven executive officers. Benefits under the plan will vest after three years of continuous service. The annual retirement benefit payable under the plan at a normal retirement date (as defined by the plan) will be a single life annuity for the life of the participant which is equal to the lesser of:

- the sum of six percent (6%) of average earnings times years of service less than or equal to five (5), plus three percent (3%) of average earnings times years of service greater than five (5), or

- sixty percent (60%) of average earnings.

Average earnings are defined as the average of the participant s annual earnings (generally, annual base compensation plus bonus paid under an annual incentive plan) during the three consecutive calendar year period of employment in which the participant had the highest aggregate earnings.

Any benefit payable under the plan will be offset by benefits, if any, payable to the participant under our pension plan. Further, a SERP participant will not accrue a benefit under our non-qualified pension restoration plan during the period in which he participates in the plan. The plan also provides death, disability and post-employment medical benefits.

On September 10, 2002, we suspended the SERP. Unless and until the plan is reactivated by us, participants in the plan will accrue no benefits; however, service during this time will count toward vesting of any benefit earned in the future. There is no certainty that the plan will be reactivated in the future. The suspension of the plan has been consented to by each of the participants.

Pension Plans

We implemented a cash balance pension plan for our salaried workforce, including the named executive officers, effective January 1, 2002. Benefits under the plan will vest after five years of continuous service. The

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plan will recognize existing service with us or our predecessors for purposes of vesting, allowing our employees that already have five or more years of service to be vested immediately.

On an annual basis each participant s account will be credited with the following:

contribution credit equal to seven percent (7%) of pensionable earnings plus seven percent (7%) of pensionable earnings in excess of the Social Security Wage Base; and

interest credit equal to the average yield for one-year treasury bonds for the previous October, plus one percent (1%).

For the purposes of the plan, pensionable earnings are defined as regular annual salary, overtime pay, annual incentive payments and contributions to 401(k) plans.

We also adopted a non-qualified restoration plan which restores the benefits lost by any employee, including any executive officer, under the qualified pension plan as a result of Internal Revenue Code imposed limitations on pensionable income.

As of December 1, 2002, the estimated annual annuities payable at age sixty-five (65) to Messrs. O Malley, Kuchta, Hantke, Eichholz, Gayda, Kuenzli, Voss and Watson are as follows:

Name	Current Age	Estimated Annual Payments(1)
Thomas D. O Malley	61	$ 126,178
Henry M. Kuchta	46	238,888
William E. Hantke	55	103,390
Dennis R. Eichholz	49	118,165
Michael D. Gayda	48	155,017
James R. Voss	36	453,991
Joseph D. Watson	37	390,696
Donovan J. Kuenzli	63	13,876

(1) Assumes the executive officer works until age sixty-five (65), annual base compensation remains unchanged from his current salary and that future incentive compensation awards are equal to 250% of base pay for Mr. O Malley, 100% of base pay for Messrs. Kuchta, Hantke, Gayda, Voss and Watson and 50% of base pay for Messrs. Eichholz and Kuenzli. Amounts include estimated benefits under our cash balance plan and non-qualified restoration plan. The interest rate used for determining the annuity was 7.5%. The interest credit for 2003 and future years was assumed to be 6.5%. The above amounts reflect that our senior executive retirement plan has been suspended and assume that each of the executive officers is eligible for benefits under the non-qualified pension restoration plan during the suspension period. For further discussion regarding the suspension of that plan, see Other Employee Benefits Senior Executive Retirement Plan.

On February 1, 2002, we implemented a cash balance pension plan for our represented workforce. Eligible represented employees are regular hourly-paid employees that have attained six months of continuous service with us. Benefits under the plan will vest after five years of continuous service. Past service from the most recent period of continuous employment at the facility will be recognized for participation and vesting. On an annual basis each participant s account is credited with:

a contribution credit equal to a percentage of pensionable earnings; and

an interest credit equal to the average yield for one-year treasury bonds for the previous October, plus one percent (1%).

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For the purposes of the pension plan, pensionable earnings are defined as annual base salary plus overtime and shift differential paid during the plan year. The contribution credit is based on the participant s age and service at year end.

Change-In-Control, Retention and Severance Agreements

We entered into change-in-control, retention and severance agreements with six of our key employees, including Messrs. Eichholz and Kuenzli. Each agreement has an initial term of three years, provided that if neither us nor the employee gives 12 months notice of termination prior to the expiration of the initial term or any extension thereof, then the agreement shall automatically extend for an additional two-year period. In the event of a change in control of us, each agreement shall remain in effect until at least the second anniversary of the change in control. In the event that, prior to the occurrence of a change in control, an employee s employment is terminated by us without cause or is terminated by the employee for good reason (defined to include a material diminution of duties or titles, certain reductions in base salary, target incentive opportunity or employee benefits), then we shall pay the employee his or her base salary during the one-year period following such termination, plus a pro-rata portion of the employee s annual target bonus for the year in which the termination occurs. In the event such termination occurs in connection with or after a change in control, the employee will receive a lump sum cash payment within 10 business days of the termination equal to two times the sum of his or her base salary amount and target bonus amount plus a pro-rata portion of his or her annual target bonus for the year in which the termination occurs. If the employee s employment is terminated for the reasons set forth above, the employee will also receive up to two years of continued medical and other welfare benefits, as well as up to one year of outplacement services.

The agreements also provide that upon a change in control of us, all stock options and other equity awards immediately vest and become exercisable (performance-vesting options only vest if the applicable performance goals are satisfied). In addition, the agreements provide that each covered employee is entitled to have his or her salary grossed up, on an after-tax basis, for any excise taxes imposed under the Internal Revenue Code on any excess parachute payment that he or she receives in connection with benefits and payments provided to him or her in connection with any change in control (as such term is defined under the Internal Revenue Code) of us.

Premcor Retirement Savings Plan

Our Savings Plan permits our employees to make before-tax and after-tax contributions and provides for employer incentive matching contributions. Executive officers participate in the plan on the same terms as other eligible employees, subject to any legal limits on the amounts that may be contributed or paid to executive officers.

Under the Savings Plan, each of our employees may become a participant. Participants are permitted to make before-tax contributions to the Savings Plan, effected through payroll deduction, of from 1% to 15% of their compensation. Compensation, for purposes of the Savings Plan, is defined as regular annual salary, overtime pay and shift differential. We make matching contributions equal to 200% of a participant s before-tax contributions for up to 3% of compensation. Additionally, for union represented employees at our Port Arthur and Lima refineries, we make matching contributions equal to 100% of a participant s before-tax contributions between 4% and 6% of compensation. Participants are also permitted to make after-tax contributions through payroll deduction, of from 1% to 5% of compensation, which are not matched by employer contributions. Before-tax contributions and after-tax contributions, in the aggregate, may not exceed the lesser of 15% of compensation and before tax contributions may not exceed $11,000 in 2002. All employer contributions for non-union employees are fully vested from the onset of the employee s participation in the plan. Subject to certain restrictions, employees may make loans or withdrawals of employee contributions during the term of their employment.

Other Plans

We provide medical benefits, life insurance, and other welfare benefits to our employees, including our executive officers.

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PRINCIPAL STOCKHOLDERS

The following table sets forth certain information concerning the beneficial ownership of our common stock as of January 1, 2003 by persons who beneficially own more than 5% of the outstanding shares of our common stock, each person who is a director of our company, each person who is a named executive officer and all directors and executive officers of our company as a group.

	Shares Beneficially Owned Prior to the Offering		Shares Beneficially Owned After the Offering (4)	
Name and Address	**Number**	**Percent**	**Number**	**Percent**
Blackstone Management Associates III L.L.C. (1) 345 Park Avenue New York, NY 10154	27,817,104	47.9%	27,817,104	40.0%
Occidental Petroleum Corporation 10889 Wilshire Boulevard Los Angeles, California 90024	7,734,646	13.3	7,734,646	11.1
Thomas D. O Malley (2)	1,483,334	2.6	1,483,334	2.1
Jefferson F. Allen (2)	83,334	*	83,334	*
Marshall A. Cohen (2)	116,161	*	116,161	*
Wilkes McClave III (2)	83,334	*	83,334	*
Donovan J. Kuenzli (2)	41,000	*	41,000	*
Dennis R. Eichholz (2)	41,000	*	41,000	*
All directors and executive officers as a group (2)(3)	1,848,163	3.2	1,848,163	2.7

* Less than 1%.

(1) Blackstone affiliates currently own 27,817,104 shares of our common stock as follows: 22,193,918 shares by Blackstone Capital Partners III Merchant Banking Fund L.P., 3,954,154 shares by Blackstone Offshore Capital Partners III L.P. and 1,669,032 shares by Blackstone Family Investment Partnership III L.P, for each of which Blackstone Management Associates III L.L.C., or BMA, is the general partner having voting and investment power. Messrs. Peter G. Peterson and Stephen A. Schwarzman are the founding members of BMA and as such may be deemed to share beneficial ownership of the shares owned by Blackstone. Each of BMA and Messrs. Peterson and Schwarzman disclaims beneficial ownership of such shares.

(2) Includes the following shares which such persons have, or will within 60 days of January 1, 2003 have, the right to acquire upon the exercise of stock options: Mr. O Malley 733,334; Mr. Allen 33,334; Mr. Cohen 50,505; Mr. McClave 33,334; Mr. Kuenzli 40,000; and Mr. Eichholz 40,000. Mr. Cohen s address is Cassels, Brock & Blackwell, Scotia Plaza, Suite 2200, 40 King Street West, Toronto Ontario, M5H-3C2 Canada. The address of each of the named executive officers is Premcor Inc., 1700 E. Putnam Avenue, Suite 500, Old Greenwich, CT 06870.

(3) David I. Foley, Robert L. Friedman and Richard C. Lappin, all directors of us, are designees of Blackstone Management Associates III L.L.C., which has investment and voting control over the shares held or controlled by Blackstone and as such may be deemed to share beneficial ownership of the shares held or controlled by Blackstone. Stephen I. Chazen, a director of us, is an executive officer of Occidental Petroleum Corporation and to the extent he may be deemed to be a control person of Occidental Petroleum Corporation may be deemed to be a beneficial owner of shares of common stock owned by Occidental Petroleum Corporation. Each of such persons disclaims beneficial ownership of such shares.

(4) Assumes no shares of common stock are sold by us in the private equity commitment and no exercise of the underwriters over-allotment option.

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RELATED PARTY TRANSACTIONS

Each of the related party transactions described below was negotiated on an arm s length basis. We believe that the terms of each such agreement are as favorable as those we could have obtained from parties not related to us.

Our Relationship with Blackstone

The Blackstone Group L.P. is a private investment firm based in New York, founded in 1985. Its main businesses include private equity investing, merger and acquisition advisory services, restructuring advisory services, real estate investing, mezzanine debt investing, collateralized debt obligation investing and asset management. Blackstone Capital Partners III Merchant Banking Fund L.P. and its affiliates, or Blackstone, acquired its interest in our predecessor in November 1997 and, as of January 1, 2003, beneficially owned 47.9% of our common stock.

Under a Monitoring Agreement, dated November 14, 1997, among us, Premcor USA and Blackstone, we have paid a monitoring fee equal to $2 million per annum to an affiliate of Blackstone. In return, Blackstone provided financial advisory services to us including advice on the structure and timing of our entry into financial arrangements, relationships with key lenders, property dispositions and acquisitions, and other ancillary financial advisory services. Financial advisory services rendered by Blackstone relating to specific acquisitions and divestitures are expressly excluded from the agreement. As of December 31, 2001, we have paid in full all amounts due and payable under this agreement. Over the past three years, we have paid fees to Blackstone totaling approximately $17 million, consisting of $6.0 million in monitoring fees, a $2.4 million fee paid in connection with our purchase of the Lima refinery, an $8.0 million fee in connection with structuring of the heavy oil upgrade project, and an amount for reimbursed expenses. We have terminated this monitoring agreement effective as of March 31, 2002. To terminate such agreement, we have paid Blackstone $500,000 for services rendered during 2002 and a $5 million termination fee.

Under a Stockholder Agreement dated March 9, 1999 among us, Blackstone and Marshall A. Cohen, one of our directors and stockholders, if Blackstone transfers 25% or more of its holdings of our common stock to a third party, Mr. Cohen or any of his permitted affiliates may require the transferee to purchase a similar percentage of his shares. Conversely, if Blackstone receives and accepts an offer from a third party to purchase 25% or more of its holdings of our common stock, Mr. Cohen must transfer a similar percentage of his shares to the third party. This agreement terminates when Blackstone ceases to beneficially own at least 5% of our common stock on a fully diluted basis.

Pursuant to a Registration Rights Agreement, dated April 26, 2002, between us and Blackstone, Blackstone has the right, on up to three occasions, to request that we effect the registration of all or part of Blackstone s shares. We are obligated to use our best efforts to effect the registration of all of the shares of which Blackstone requests except when in the opinion of the underwriter the number of securities requested to be registered is likely to adversely impact such offering. Blackstone also has the right to include its shares in certain registered public offerings by us. We are obligated to use our best efforts to effect the registration of the Blackstone shares along with the other shares, absent a determination by the underwriter that such registration exceeds the largest number of securities which can be sold without adversely impacting the offering.

Blackstone is also a party to a Capital Contribution Agreement, dated as of August 19, 1999, with Sabine, Neches, PACC, PAFC and us. Under that agreement, Blackstone agreed to make certain capital investments in Sabine in connection with the heavy oil upgrade project. Blackstone made $109.6 million of contributions under the agreement.

From time to time in the past, we have retained Blackstone to act as our financial advisor with respect to potential transactions. Blackstone is not currently acting as our financial advisor with respect to any such transaction.

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Our Relationship with Occidental

Occidental Petroleum Corporation explores for, develops, produces and markets crude oil and natural gas and manufactures and markets a variety of basic chemicals. Occidental acquired its interest in our predecessor in 1995 and, as of January 1, 2003, beneficially owned 13.3% of our common stock. Occidental also acquired an approximately 10% equity interest in Sabine pursuant to a Subscription Agreement, dated as of August 4, 1999, among Occidental, Sabine, Neches and PACC, in connection with the financing of the Port Arthur heavy oil upgrade project.

Pursuant to a Share Exchange Agreement dated April 27, 1999, we succeeded to, and Premcor USA ceased to be a party to, the Second Amended and Restated Stockholders Agreement dated November 3, 1997, originally between Premcor USA and Occidental C.O.B. Partners. That stockholders agreement entitles Occidental to designate one director to our board of directors for as long as it holds at least 10% of our fully diluted shares. We have the right of first refusal on any of our shares held by Occidental or a transferee of Occidental intended by such holder to be sold to a third party. Occidental has the right, on one occasion, to request that we effect the registration of all or part of Occidental s holdings of our common stock. In addition, Occidental has the right to include its holdings of common stock in any registered public offering by us. We are required to use our best efforts to effect the registration of the shares of our common stock held by Occidental along with our other shares of common stock, unless the underwriters of the offering determine that the registration of the shares of our common stock held by Occidental will adversely impact the offering of our other shares of common stock.

Under an Advisory Agreement, dated November 14, 1997, among Premcor USA, PRG and Occidental, Occidental provides us with consulting services related to ongoing crude supplier decisions and related purchase and hedging strategies. In return, Occidental received 101,010 shares of our Class F Common Stock. Pursuant to a Warrant Exercise and Share Exchange Agreement, dated as of June 6, 2002, among Blackstone, Occidental, Sabine and us, Occidental s 101,010 shares of our Class F Common Stock were converted into shares of our common stock upon completion of our IPO and, in connection with the Sabine restructuring, we consummated a share exchange with Occidental whereby we received the remaining 10% of the common stock of Sabine in exchange for shares of our common stock.

Our Relationship with PACC

Prior to the Sabine restructuring, PACC was our affiliate because we owned 90% of the capital stock of Sabine, the entity formed to be the general partner of PACC, and 100% of Neches, the entity formed to be the 99% limited partner of PACC. In connection with the Sabine restructuring, on June 6, 2002, we consummated a share exchange with Occidental whereby we received the remaining 10% of the common stock of Sabine and we then contributed its 100% ownership interest in Sabine to PRG. As a result, Sabine and its wholly owned subsidiaries, including PACC, became wholly-owned subsidiaries of PRG.

Consulting Agreement with Fuel Strategies International

Pursuant to a consulting agreement, Fuel Strategies International, Inc., the principal of which is James P. O Malley, the brother of Thomas O Malley, our chairman and chief executive officer, provides us with monthly consulting services relating to our petroleum coke operations. The initial term of the agreement runs from June 1, 2002 through May 30, 2003, and shall be automatically renewed for additional one-year periods unless terminated by either party upon 90 days notice prior to the expiration of the initial term or any renewal term. The agreement provides that Fuel Strategies will be paid a fixed fee of $12,000 per month for eight working days and $1,500 per day for each additional day thereafter. Fuel Strategies also is entitled to be reimbursed for its expenses and to be paid an additional $450 per day for expenses it may incur on business trips outside of Boca Raton, Florida. Effective October 2002, Fuel Strategies voluntarily agreed to work 10 days per month for its fixed monthly fee of $12,000 and to reduce its per diem fee for additional days to $1,200, which will be capped at a maximum rate of 12 days per month regardless of the actual number of days worked. For the year ended December 31, 2002, we paid $168,198 to Fuel Strategies under this agreement.

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DESCRIPTION OF CAPITAL STOCK

General

Upon consummation of this offering, our authorized capital stock will consist of:

150,000,000 shares of common stock, par value $0.01 per share, and

5,000,000 shares of preferred stock, par value $0.01 per share.

The following description of our capital stock and related matters is qualified in its entirety by reference to our certificate of incorporation and by-laws, copies of which are filed as exhibits to the registration statement of which this prospectus forms a part.

Common Stock

Voting Rights; Dividends; Other Rights

Holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders, voting together as one class, except that holders of common stock are not entitled to vote with respect to matters reserved, by law or agreements, solely to any other class of capital stock. The holders of common stock do not have cumulative voting rights in the election of directors.

Holders of common stock are entitled to receive dividends payable either in cash, in property or in shares, if, as and when declared by our board of directors, out of assets legally available for that purpose. Dividend payments are subject to preferential rights, if any, of the preferred stock. Upon our liquidation, dissolution or winding up, after payment or provision for the payment of our debts and other liabilities and of the preferential amounts, if any, to which the holders of preferred stock are entitled, the holders of all outstanding shares of common stock will be entitled to receive our remaining assets that will be distributed ratably in proportion to the numbers of shares held by each holder of common stock. The common stock has no preemptive or conversion rights and is not subject to further calls or assessment by us. There are no redemption or sinking fund provisions applicable to shares of common stock.

Preferred Stock

Our certificate of incorporation authorizes our board of directors to establish one or more classes of preferred stock, to establish the number of shares to be included in each class and to fix the designations, powers, preferences and rights of the shares of each class of preferred stock and any qualifications, limitations or restrictions thereof.

Although we have no intention at the present time of establishing a new class of preferred stock, our certificate of incorporation allows us to do so as an anti-takeover defensive measure to impede an unsolicited acquisition proposal, tender offer or other takeover attempt. We will make any determination to establish a new class, and issue shares, of preferred stock based on our judgment as to the best interests of the company and our stockholders. Such class of preferred stock may have terms and conditions that discourage unsolicited acquisition proposals or other takeover attempts that some or a majority of you might believe to be in your best interests or in which you might receive a premium for you shares of common stock over the market price of such shares of common stock.

Authorized but Unissued Capital Stock

The Delaware General Corporation Law does not require stockholder approval for any issuance of authorized shares of common stock. However, the listing requirements of the New York Stock Exchange, that would apply so long as our common stock remains listed on the New York Stock Exchange, require stockholder approval of certain issuances equal to or exceeding 20% of the then outstanding voting power or then outstanding number of shares of common stock. These additional shares may be used for a variety of corporate purposes, including future public offerings, to raise additional capital or to facilitate acquisitions.

One of the consequences of the existence of unissued and unreserved common stock or preferred stock may be that our board of directors could issue shares to persons friendly to current management, which could render more difficult or discourage an attempt to obtain control of us by means of a merger, tender offer, proxy contest or otherwise, and thereby protect the continuity of our management and possibly deprive stockholders of opportunities to sell their shares of common stock at prices higher than prevailing market prices.

Anti-Takeover Effects of Provisions of Delaware Law and Our Certificate of Incorporation and By-Laws

Delaware Law

We are a Delaware corporation subject to Section 203 of the Delaware General Corporation Law. Section 203 provides that, subject to certain exceptions specified in the law, a Delaware corporation will not engage in certain business combinations with any interested stockholder for a three-year period following the time that the stockholder became an interested stockholder unless:

prior to the time that the stockholder becomes an interested stockholder, our board of directors approved either the business combination or the transaction that resulted in the stockholder becoming an interested stockholder;

upon consummation of the transaction that resulted in the stockholder becoming an interested stockholder, the interested stockholder owned at east 85% of our voting stock outstanding at the time the transaction commenced, excluding certain shares; or

at or subsequent to the time that the stockholder becomes an interested stockholder, the business combination is approved by our board of directors and by the affirmative vote of holders of at least 66 $^{2}/3$% of the outstanding voting stock not owned by the interested stockholder.

Generally, the term business combination includes a merger, asset or stock sale or other transaction resulting in a financial benefit to the interested stockholder. Subject to certain exceptions, an interested shareholder is a person who, together with that person s affiliates and associates, owns, or within the previous three years did own, 15% or more of our voting stock.

Under certain circumstances, Section 203 makes it more difficult for a person who is an interested stockholder to effect various business combinations with a corporation for a three-year period. The provisions of Section 203 may encourage companies interested in acquiring us to negotiate in advance with our board of directors for approval of certain transactions or business combinations in order to avoid the stockholder approval requirement. Section 203 also may have the effect of preventing changes in our board of directors and may make it more difficult to accomplish transactions that stockholders may otherwise deem to be in their best interests.

Certificate of Incorporation; By-Laws

Our certificate of incorporation and by-laws contain certain provisions that could make more difficult the acquisition of us by means of a tender offer, a proxy contest or otherwise.

Removal of Directors; Vacancies. Our certificate of incorporation and by-laws provide that directors may be removed only for cause and only upon the affirmative vote of holders of at least 75% of the voting power of the then outstanding shares of stock entitled to vote generally in the election of directors, voting together as a single class. Our certificate of incorporation also provides that any vacancies on our board of directors will be filled only by the affirmative vote of a majority of the remaining directors, though less than a quorum.

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Action by Written Consent; Stockholder Action. Our certificate of incorporation and by-laws provide that stockholder action can be taken only at an annual or special meeting of stockholders and may not be taken by written consent in lieu of a meeting. This provision will prevent the holders of a majority of the voting stock from using a written consent procedure to take stockholder action without affording all stockholders an opportunity to vote on the action. In addition, our certificate of incorporation and by-laws provide that, except as permitted by law and subject to the rights of holders of preferred stock, special meetings of stockholders can be called only by the chairman of our board of directors or the chief executive officer and will be called by our secretary at the direction of a majority of the board of directors. These stockholder action provisions have the effect of discouraging, delaying or preventing a change in control.

Advance Notice Procedure. Our by-laws establish an advance notice procedure for stockholders to nominate candidates for election as directors, or to bring business before an annual meeting of stockholders. Only persons nominated by, or at the direction of, our board of directors or by a stockholder who has given timely written notice to the secretary of our company prior to the meeting, will be eligible for election as a director. In addition, any proposed business other than the nominations of persons for election to our board of directors must constitute a proper matter for stockholder action pursuant to the notice of meeting delivered to our company. For notice to be timely, it must be received by the secretary of our company not less than 90 days nor more than 120 days prior to the first anniversary of the previous year s annual meeting (or if the date of the annual meeting is advanced by more than 30 days or delayed by more than 70 days from such anniversary date, not earlier than the 120^{th} day prior to such meeting and not later than the later of (x) the 90^{th} day prior to such meeting and (y) the 10^{th} day after public announcement of the date of such meeting is first made). In the event that the number of directors to be elected to the board is increased and there is no public announcement by our company naming the nominees for directors at least 100 days prior to the first anniversary of the preceding year s annual meeting, a stockholder s notice will be timely, but only with respect to nominees for the additional directorships, if it is delivered to the secretary of our company not later than the 10^{th} day following the day on which such public announcement is first made. For notice of a stockholder nomination to be made at a special meeting at which directors are elected, such notice must be received by our company not earlier than the 120^{th} day before such meeting and not later than the later of (x) the 90^{th} day prior to such meeting and (y) the 10^{th} day after the date the public announcement is first made. A stockholder s notice proposing to nominate a person for election as a director or relating to the conduct of other business must contain certain specified information. If the chairman of our board of directors determines that a person was not nominated, or other business was not brought before the meeting in accordance with the notice procedure, that person will not be eligible for election as a director, and that business will not be conducted at the meeting.

Amendment. Our certificate of incorporation and by-laws provide that the affirmative vote of the holders of at least 75% of the voting power of all shares entitled to vote generally in the election of directors, voting together as a single class, is required to amend provisions of the certificate of incorporation relating to:

- prohibition of stockholder action without a meeting;
- the ability of our stockholders to call a special meeting;
- the number, election and term of the members of the board of directors; and
- the removal of directors.

Our certificate of incorporation further provides that our by-laws may be amended by our board of directors or by the affirmative vote of the holders of at least 75% of the voting power of all shares entitled to vote generally in the election of directors, voting together as a single class.

Registrar and Transfer Agent

The registrar and transfer agent for the common stock is American Stock Transfer & Trust Company.

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Limitation of Liability and Indemnification

Our by-laws provide that we will indemnify and advance expenses to our directors and officers to the fullest extent authorized by the Delaware General Corporation Law, as it now exists or may in the future be amended, against all expenses and liabilities reasonably incurred in connection with their service for or on behalf of our company. In addition, our certificate of incorporation provides that our directors will not be liable for monetary damages to us for breaches of their fiduciary duty as directors, except to the extent such exemption from liability or limitation thereof is not permitted under the Delaware General Corporation Law.

Listing

Our common stock is listed on the New York Stock Exchange under the symbol PCO.

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DESCRIPTION OF INDEBTEDNESS

The following are summaries of the terms of our principal long-term debt.

The Premcor Refining Group

8 3/8% Senior Notes. In November 1997, The Premcor Refining Group issued $100 million of unsecured 8 3/8% senior notes. The notes mature on November 15, 2007, with interest payable semi-annually in arrears on May 15th and November 15th. The Premcor Refining Group may redeem the notes on or after November 15, 2002, at a redemption price equal to 104.187% of the principal amount of the notes in the first year. The redemption prices decline yearly to par on November 15, 2004, plus accrued and unpaid interest to the date of redemption.

8 7/8% Senior Subordinated Notes. In November 1997, The Premcor Refining Group issued $175 million of unsecured 8 7/8% senior subordinated notes. The notes mature on November 15, 2007, with interest payable semi-annually in arrears on May 15th and November 15th. The Premcor Refining Group may redeem the notes on or after November 15, 2002, at a redemption price equal to 104.437% of the principal amount of the notes in the first year. The redemption prices decline yearly to par on November 15, 2005, plus accrued and unpaid interest to the date of redemption. The notes are senior subordinated obligations of The Premcor Refining Group, subordinated in right of payment to all of its senior debt.

Floating Rate Loans. The Premcor Refining Group borrowed $125 million in November 1997, and an additional $115 million in August 1998, under a floating rate term loan agreement expiring in 2004. In November 2003, $31.3 million of the outstanding principal amount is due with the remainder of the outstanding principal due in November 2004. The loan is a senior unsecured obligation of The Premcor Refining Group and bears interest at the London Interbank Offer Rate, or LIBOR, plus a margin of 275 basis points. The loan may be repaid from time to time at any time in whole or in part, without premium or penalty. We intend to repay the floating rate term loan with the proceeds from this offering and the other financing transactions.

8 5/8% Senior Notes. In August 1998, The Premcor Refining Group issued $110 million of unsecured 8 5/8% senior notes. The notes mature on August 15, 2008, with interest payable semi-annually in arrears on February 15th and August 15th. The Premcor Refining Group may redeem the notes on or after August 15, 2003, at a redemption price equal to 104.312% of the principal amount of the notes in the first year. The redemption prices decline yearly to par on August 15, 2005, plus accrued and unpaid interest to the date of redemption.

Change of Control Provisions

Holders of each of the notes described above have the right, upon the occurrence of a change of control accompanied by a ratings downgrade, to require us to repurchase that holder s notes at a price equal to 101% of their principal amount, plus accrued and unpaid interest to the repurchase date. Each lender under the floating rate loan agreement described above has the right, upon a change of control accompanied by a ratings downgrade, to require us to repay that lender s loan plus a fee of 1% of the principal repaid.

Restrictive Covenants

The indentures governing each of the notes and the floating rate term loan agreement described above contain covenants that, among other things, limit our ability to:

- lease, convey or otherwise dispose of substantially all of our assets or those of our subsidiaries or merge or consolidate;

- pay dividends or make other distributions on our capital stock, repay subordinated obligations, repurchase capital stock or make specified types of investments, unless we either have the requisite adjusted net worth or can incur an additional $1 of new debt under the operating cash flow to fixed

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charge ratio mentioned below and unless the aggregate amount of specified restricted repayments and investments does not exceed a customary formula based on 50% of net operating income accrued since a specified date at or near the date of the applicable instrument, plus capital contributions; exceptions include dividends up to $75 million for investments and up to $50 million for other restricted payments;

incur debt unless, after giving effect to the incurrence of the new debt and the application of the proceeds therefrom, the ratio of operating cash flow to fixed charges would be greater than 2 to 1; exceptions include bank borrowings up to a borrowing base; junior subordinated debt and debt equal to twice capital contributions in certain instruments; and other debt not to exceed the greater of $25 million and 1.25 million multiplied by the per barrel price of West Texas Intermediate crude oil in some instruments and $50 million or $75 million in others;

permit our subsidiaries to issue guarantees of indebtedness;

incur liens;

sell assets without receiving fair market value, 75% of the consideration in cash or cash equivalents or through the assumption by the buyer of debt and without having to apply the net proceeds to repay debt or reinvest in its business;

issue capital stock of certain subsidiaries;

restrict our subsidiaries ability to make dividend payments;

enter into transactions with affiliates; and

enter into sale leaseback transactions.

If the 8 $^{3}/8$%, 8 $^{5}/8$%, 8 $^{7}/8$% notes or the floating rate loans are assigned an investment grade rating, certain of these covenants cease to apply to us and less restrictive covenants that limit only secured indebtedness and sale and leaseback transactions apply instead.

The Premcor Refining Group Credit Agreement

The credit agreement of our subsidiary, The Premcor Refining Group, provides for letter of credit issuances and revolving loan borrowings of up to the lesser of $650 million (which amount may be increased by up to $50 million under certain circumstances) and the amount of the borrowing base, calculated, on the date of determination, as the sum of 100% of eligible cash (less certain intercompany payables) and eligible cash equivalents, 95% of eligible investments, 90% of major oil company receivables, 85% of eligible receivables, 80% of eligible petroleum inventory, 80% of eligible petroleum inventory-not-received, and 100% of paid but unexpired standby letters of credit *minus* the greater of (i) the aggregate of all net obligations of PRG to any bank swap party under any swap contracts on such date of determination and (ii) zero. Similar assets of Sabine and its subsidiaries may be included in the calculation of the borrowing base on the same basis as assets of PRG. Revolving loans are limited to the principal amount of $50 million. The letters of credit and the proceeds of revolving loans may be used for working capital and general corporate purposes.

The Premcor Refining Group s credit agreement is structured in two tranches, Tranche 1 of $150 million and Tranche 2 of $500 million. The Tranche 1 commitments are considered fully utilized at all times, while Tranche 2 commitments are considered utilized in an amount equal to the result of subtracting the Tranche 1 commitments from the total letters of credit outstanding at any time.

Borrowings and other obligations under the credit agreement and certain hedging agreements are secured by a lien on substantially all of PRG s personal property, including inventory, accounts, contracts, cash and cash equivalents, general intangibles, including security and deposit accounts, intellectual property, books and records, futures and forwards accounts, commodities accounts, supporting obligations and after-acquired property and proceeds of the foregoing, other than in each case general intangibles arising from or related to its real property, buildings, structures, and other improvements, fixtures, apparatus, machinery, appliances and other

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equipment, and all extensions, renewals, improvements, substitutions and replacements thereto whether owned or leased, together with rents, income, revenues, issues and profits from and in respect of such property. The collateral also includes the capital stock of Sabine and certain inventory assets of PACC and certain proceeds thereof.

Outstanding loans under the credit agreement bear interest at annual floating rates equal to LIBOR plus marginal rates between 2.50% and 3.00% or the agent bank s prime rate plus marginal rates between 1.50% and 2.00%. Unused commitments under the credit agreement are subject to a per annum commitment fee ranging from 0.75% to 1.25%. The marginal rates are subject to adjustment based upon our senior unsecured debt rating. The credit agreement terminates, and all amounts outstanding thereunder are due and payable, on August 23, 2003. The credit agreement contains representations and warranties, funding and yield protection provisions, borrowing conditions precedent, financial and other covenants and restrictions, events of default and other provisions customary for bank credit agreements of this type.

Covenants and provisions contained in the credit agreement restrict (with certain exceptions), among other things, the ability of The Premcor Refining Group and its restricted subsidiaries, in each case subject to certain exceptions:

- to create or incur liens;
- to engage in certain asset sales;
- to engage in mergers, consolidations, and sales of substantially all assets;
- to make loans and investments;
- (covers PRG and all subsidiaries) to incur additional indebtedness;
- to engage in certain transactions with affiliates;
- (covers PRG and all subsidiaries) to use loan proceeds to acquire or carry margin stock, or to acquire securities in violation of certain sections of the Exchange Act;
- to create or become or remain liable with respect to certain contingent liabilities;
- to enter into certain joint ventures;
- to enter into certain lease obligations;
- to make certain dividend, debt and other restricted payments;
- to engage in different businesses;
- (covers all subsidiaries) to make any significant change in our accounting practices;
- (covers certain affiliates) to incur certain liabilities or engage in certain prohibited transactions under the Employee Retirement Income Security Act of 1974, or ERISA;
- to maintain deposit accounts not under the control of the banks that are parties to the credit agreement, or to take certain other action with respect to its bank accounts;
- (covers PRG and all subsidiaries) to engage in speculative trading;
- (covers PRG and all subsidiaries) to amend, modify or terminate certain material agreements;
- to maintain cash in certain accounts of Sabine and its subsidiaries in excess of certain levels; and
- to enter into contracts limiting the ability of restricted subsidiaries to pay dividends and make payments to PRG or other restricted subsidiaries.

We are required to cause Sabine and its subsidiaries to forgive certain intercompany indebtedness owed by us to them under certain circumstances. We are also required to comply with certain financial covenants. The current financial covenants are:

- maintenance of working capital of at least $150 million at all times;

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- maintenance of tangible net worth of at least $400 million; and
- maintenance of the aggregate amount of its eligible cash, eligible cash equivalents and eligible investments that are both (a) in or for the benefit of collateral accounts existing prior to the date of the credit agreement and (b) permitted thereby, of at least $75 million.

The covenants also provide for a cumulative cash flow test, as defined in the credit agreement, that, from July 1, 2001, shall not be less than or equal to zero. The credit agreement also limits the amount of future additional indebtedness that may be incurred by us and our subsidiaries, subject to certain exceptions, including a general exception for up to $75 million of indebtedness (which amount may be increased to up to $200 million if our consolidated debt to capitalization ratio (after giving pro forma effect to the incurrence of such indebtedness) is less than or equal to 0.60), no more than $25 million of which may mature before or concurrently with the credit agreement.

Events of default under the credit agreement include, among other things:

- any failure by us to pay principal thereunder when due, or to pay interest or any other amount due within three days after the date due;
- material inaccuracy of any representation or warranty given by us or any restricted subsidiary therein or in any document delivered pursuant thereto;
- breach by us of certain covenants contained therein;
- the continuance of a default by us or a subsidiary in the performance of or the compliance with other covenants and agreements for a period of 3 or 20 days depending on the covenant, in each case after the earlier of (x) the date upon which a responsible officer knew or reasonably should have known of such failure and (y) the date upon which written notice thereof is given to us by the administrative agent or any bank;
- breach of or default under any indebtedness in excess of $5 million and continuance beyond any applicable grace period;
- certain acts of bankruptcy or insolvency;
- the occurrence of certain events under ERISA;
- certain judgments, writs or warrants of attachment of similar process equal to or greater than $5 million remaining undischarged, unvacated, unbonded, or unstayed for a period of 10 days or non-monetary judgments, orders or decrees which do or would reasonably be expected to have a material adverse effect;
- the occurrence of a change of control;
- the revocation of or failure to renew licenses or permits where such revocation or failure to renew could reasonably be expected to have a material adverse effect;
- the failure of the liens of the banks to be first priority perfected liens, subject to certain permitted liens or unenforceability or written assertion of limitation or unenforceability by PRG or any subsidiary, of any collateral document; or
- Premcor USA incurs on or after August 23, 2001 any secured or unsecured indebtedness in the aggregate in excess of $25 million.

We must amend this credit agreement to extend the maturity date from August 23, 2003 to three years from closing of the amendment and obtain various waivers and approvals in order to consummate the debt financing and the acquisition of the Memphis refinery. In addition, we are seeking to amend and restate this credit agreement to, among other things, increase the capacity under the agreement from $650 million to the lesser of

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$750 million or the amount available under the borrowing base; and increase the sub-limit for cash borrowings from $50 million to $200 million, subject to certain restrictions. Certain covenants relating to minimum cash requirements, permitted indebtedness and minimum net worth requirements will also be modified. There are no assurances that we will be able to obtain the necessary extension, waivers and approvals or enter into an amended and restated credit agreement on these terms or at all.

Premcor USA

11 1/2% Subordinated Debentures. In October 1997, Premcor USA Inc. issued 63,000 shares of 11 1/2% senior cumulative exchangeable preferred stock, stated value $1,000 per share. Premcor USA gave notice on March 1, 2002 to exchange the 11 1/2% exchangeable preferred stock for 11 1/2% subordinated debentures of Premcor USA, due 2009. The exchange of $104.2 million aggregate liquidation preference of 11 1/2% exchangeable preferred stock for $104.2 million aggregate principal amount of subordinated debentures was consummated effective April 1, 2002. In 2002, Premcor USA used contributions from us from the proceeds of our IPO to purchase $57.5 million in aggregate principal amount of the 11 1/2% subordinated debentures at a purchase price of 105.750% of their principal amount. Premcor USA may redeem the subordinated debentures on or after October 1, 2002, in whole or in part, at a redemption price equal to 105.750%. The redemption prices decline yearly to par on October 1, 2005, plus accrued and unpaid interest to the date of redemption. Upon a change of control occurring after October 1, 2005, Premcor USA is required to offer to purchase all outstanding subordinated debentures at par plus accrued and unpaid interest, if any. We intend to defease the outstanding 11 1/2% subordinated debentures prior to the closing of the debt financing and thereafter redeem them with the proceeds from this offer.

Port Arthur Finance Corp.

12 1/2% Senior Secured Notes. In August 1999, Port Arthur Finance Corp. issued $255 million of 12 1/2% senior secured notes, of which $4.3 million was repaid on July 15, 2002. The notes are secured by certain of the assets of Port Arthur Finance Corp. and Port Arthur Coker Company. The collateral does not include PACC s crude oil inventory, refined or intermediate products or any proceeds of the foregoing that are cash or cash equivalents and is shared ratably among the senior lenders pursuant to a common security agreement. Each of PRG, Port Arthur Coker Company, Sabine River Holding and Neches River Holding have unconditionally guaranteed, on a joint and several basis, all the obligations of Port Arthur Finance Corp. under the notes. The notes amortize over time, with principal payments due semi-annually on January 15th and July 15th until January 15, 2009. We may redeem all of the notes at any time at a redemption price equal to par plus accrued and unpaid interest plus a make-whole premium which is based on the rates of treasury securities with average lives comparable to the average life of the remaining scheduled payments plus 75 basis points.

Restrictive Covenants

The 12 1/2% senior secured notes contain covenants which, among other things, limit the ability of PRG, Port Arthur Coker Company, Port Arthur Finance Corp., Sabine River Holding and Neches River Holdings to:

- amend or modify their constitutive or governing documents;
- conduct any business other than the business of the heavy oil upgrade project;
- sell, assign, lease, transfer or otherwise dispose of project property without the consent of the lenders (and where applicable secured parties), with certain exceptions;
- incur debt; and
- make investments or advances or loans.

Port Arthur Coker Company is subject to restrictions on the making of distributions to its general partner Sabine River Holding and its limited partner Neches River Holding. Port Arthur Coker Company is required to fund certain restricted cash accounts to be used for future capital expenditures, tax payments, major maintenance, and debt repayments.

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SHARES ELIGIBLE FOR FUTURE SALE

Upon the closing of this offering we will have outstanding an aggregate of approximately 69,543,935 shares of common stock, assuming no exercise of outstanding options or exercise of the over-allotment option. In addition, in connection with the Memphis refinery acquisition, under certain circumstances, we may pay up to $100 million of the purchase price through the issuance of our shares of common stock instead of cash. These shares of common stock would be valued at the lesser of (1) $15.00 per share less an underwriting discount or (2) $, the net proceeds per share received by us in this offering. See The Acquisition of the Memphis Refinery Overview of the Acquisition. We are also currently evaluating several other refinery acquisitions, some of which may be significant. Any other significant acquisition may require us to issue shares of our common stock or securities linked to shares of our common stock to finance all or a portion of such acquisition.

Of the outstanding shares, the 18,000,000 shares sold in our IPO and the 11,500,000 shares sold in this offering will be freely tradable without restriction or further registration under the Securities Act, except that any shares held by our affiliates, as that term is defined under Rule 144 of the Securities Act, may be sold only in compliance with the limitations described below. The remaining shares of common stock will be deemed restricted securities as defined under Rule 144. Restricted securities may be sold in the public market only if registered or if they qualify for an exemption from registration under Rule 144 or 144(k) under the Securities Act, which we summarize below,

Subject to the provisions of Rule 144 and 144(k), additional shares of our common stock will be available for sale in the public market under exemptions from registration requirements as follows:

Rule 144

In general, under Rule 144 as currently in effect, a person (or persons whose shares are required to be aggregated), including an affiliate, who has beneficially owned shares of our common stock for at least one year, is entitled to sell in any three-month period a number of shares that does not exceed the greater of:

1% of the then outstanding shares of common stock, or approximately 695,439 shares, assuming no exercise of the over-allotment option; and

the average weekly trading volume in the common stock on the New York Stock Exchange during the four calendar weeks preceding the date on which notice of sale is filed, subject to restrictions.

Sales under Rule 144 are also subject to manner of sale provisions and notice requirements and to the availability of current public information about us.

Rule 144(k)

In addition, a person who is not deemed to have been an affiliate of ours at any time during the 90 days preceding a sale and who has beneficially owned the shares proposed to be sold for at least two years, would be entitled to sell those shares under Rule 144(k) without regard to the manner of sale, public information, volume limitation or notice requirements of Rule 144. To the extent that our affiliates sell their shares, other than pursuant to Rule 144, Rule 144(k) or a registration statement, the purchaser receives restricted securities and the purchaser s holding period for the purpose of effecting a sale under Rule 144 commences on the date of transfer from the affiliate.

Lock-Up Agreements

In connection with this offering, we, our directors and executive officers, Blackstone and Occidental, owning an aggregate of 36,469,406 shares, have agreed that none of us will sell, directly or indirectly, subject to certain exceptions, any shares of our common stock for a period of 90 days from the date of this prospectus, without the prior written consent of Morgan Stanley & Co. Incorporated. Morgan Stanley & Co. Incorporated, in its sole discretion, may release the shares subject to the lock-up agreements in whole or in part at any time with or without notice. When determining whether to release shares from the lock-up agreements, Morgan

Stanley & Co. Incorporated will consider, among other factors, the stockholder s reasons for requesting the release, the number of shares for which the release is being requested and market conditions at the time. Morgan Stanley & Co. Incorporated does not at this time have any intention of releasing any of the shares subject to the lock-up agreements prior to the expiration of the lock-up period.

We have agreed not to sell or otherwise dispose of any shares of our common stock during the 90-day period following the date of this prospectus, except we may issue, and grant options to purchase, shares of common stock under our employee benefit plans referred to in this prospectus. In addition, we may issue shares of common stock in connection with any acquisition of another company if the terms of the issuance provide that the common stock may not be resold prior to the expiration of the 90-day period described above.

Stock Options

Options to purchase an aggregate of approximately 4,589,480 shares of our common stock will be outstanding as of the closing of this offering. Of these options, 430,080 will have vested at or prior to the closing of this offering. Of the remaining options, approximately 3,948,500 are time vesting options which will vest over the next three years and 210,900 are performance vesting options which will vest seven years from the date of grant, unless accelerated in accordance with their terms. For further discussion regarding our options granted under our stock option plans, see Management Long-Term Performance.

We have filed a registration statement on Form S-8 under the Securities Act registering all shares of common stock subject to outstanding stock options and options issuable under our stock incentive plans and shares of certain of our officers and directors. Shares covered by this registration statement are eligible for sale in the public markets, other than shares owned by our affiliates, which may be sold in the public market if they are registered or qualify for an exemption from registration under Rule 144.

Registration Rights

Occidental has the right on one occasion to request that we effect the registration of all or part of Occidental s holdings of up to 7,734,646 shares of our common stock. In addition, Occidental has the right to include its shares in any registered public offering by us, which it has waived in connection with this offering. We are obligated to use our reasonable best efforts to effect the registration of the Occidental shares along with the other shares, absent a determination that the registration of the Occidental shares will adversely impact the offering of our other shares.

Marshall A. Cohen has the right to include his holdings of up to 116,161 shares of our common stock and shares issuable upon the exercise of stock options in certain registered public offerings by us, which he has waived in connection with this offering. We are obligated to use our reasonable efforts to register Marshall A. Cohen s holdings of our common stock, absent a determination that the registration of his shares will adversely impact the offering of our other shares.

Blackstone has the right, on up to three occasions, to request that we effect the registration of all or part of Blackstone s 27,817,104 shares of our common stock. We are obligated to use our best efforts to effect the registration of all of the shares of which Blackstone requests except when in the opinion of the underwriter the number of securities requested to be registered is likely to adversely impact such offering. Blackstone also has the right to include its shares in certain registered public offerings by us, which it has waived in connection with this offering. We are obligated to use our best efforts to effect the registration of the Blackstone shares along with the other shares, absent a determination by the underwriter that such registration exceeds the largest number of securities which can be sold without adversely impacting the offering.

If the sellers receive shares of our common stock as part of the consideration for the Memphis refinery acquisition, they will also have the right, from time to time, to require us to register their stock for resale and will also have the right to include their shares in future registration statements filed by us. See The Acquisition of the Memphis Refinery.

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CERTAIN U.S. TAX CONSEQUENCES TO NON-U.S. HOLDERS

General

The following summary describes the material U.S. federal income and estate tax consequences of the ownership of common stock by a Non-U.S. Holder (as defined below) as of the date hereof. This discussion does not address all aspects of U.S. federal income and estate taxes and does not deal with foreign, state and local tax consequences that may be relevant to Non-U.S. Holders in light of their personal circumstances. Special rules may apply to certain Non-U.S. Holders, such as controlled foreign corporations, passive foreign investment companies, foreign personal holding companies, individuals who are U.S. expatriates and corporations that accumulate earnings to avoid U.S. federal income tax, that are subject to special treatment under the Internal Revenue Code of 1986, as amended, or the Code. Those individuals or entities should consult their own tax advisors to determine the U.S. federal, state, local and other tax consequences that may be relevant to them. Furthermore, all Non-U.S. Holders should consult their U.S. tax advisors regarding the appropriate documentation and certifications described below. The discussion below is based upon the provisions of the Code and regulations, rulings and judicial decisions thereunder as of the date hereof, and such authorities may be repealed, revoked or modified, possibly with retroactive effect, so as to result in U.S. federal income tax consequences different from those discussed below. If a partnership holds common stock, the tax treatment of a partner will generally depend upon the status of the partner and the activities of the partnership. A holder that is a partner in a partnership holding the common stock should consult its own tax advisor. Persons considering the purchase, ownership or disposition of common stock should consult their own tax advisors concerning the U.S. federal income tax consequences in light of their particular situations as well as any consequences arising under the laws of any other taxing jurisdiction.

As used herein, a Non-U.S. Holder of common stock means a beneficial owner that is an individual or entity other than (1) a citizen or resident of the United States, (2) a corporation or partnership (or other entity properly classified as a corporation or partnership for U.S. federal income tax purposes) created or organized in or under the laws of the United States or any state thereof (including the District of Columbia), (3) an estate the income of which is subject to U.S. federal income taxation regardless of its source or (4) a trust (A) that is subject to the primary supervision of a court within the United States and the control of one or more U.S. persons as described in section 7701(a)(30) of the Code or (B) that has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person.

Dividends

Dividends paid to a Non-U.S. Holder of common stock generally will be subject to withholding of U.S. federal income tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. However, dividends that are effectively connected with the conduct of a trade or business by the Non-U.S. Holder within the United States and, where a tax treaty applies, are attributable to United States permanent establishment of the Non-U.S. Holder, are not subject to the withholding tax, but instead are subject to U.S. federal income tax on a net income basis at applicable graduated individual or corporate rates. Certain certification and disclosure requirements must be complied with in order for effectively connected income to be exempt from withholding. Any such effectively connected dividends received by a foreign corporation may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or a lower rate as may be specified by an applicable income tax treaty.

A Non-U.S. Holder of common stock who wishes to claim an exemption from, or reduction in, withholding under the benefit of an applicable treaty rate (and avoid backup withholding as discussed below) for dividends, will be required to provide us or their paying agent with an Internal Revenue Service Form W-8BEN (generally for persons that are not partnerships or trusts it will be Form W-8BEN) and satisfy certain certification requirements of applicable U.S. Treasury regulations. Where dividends are paid to a Non-U.S. Holder that is a partnership or other pass-through entity, persons holding an interest in the entity may also be required to provide the certification.

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A Non-U.S. Holder of common stock eligible for a reduced rate of U.S. withholding tax under an income tax treaty may obtain a refund of any excess amounts withheld by filing an appropriate claim for refund with the Internal Revenue Service, or the IRS.

Gain on Disposition of Common Stock

A Non-U.S. Holder generally will not be subject to U.S. federal income tax with respect to gain recognized on a sale or other disposition of common stock unless (1) the gain is effectively connected with a trade or business in the United States of the Non-U.S. Holder, and, where a tax treaty applies, is attributable to a U.S. permanent establishment of the Non-U.S. Holder, (2) such holder is an individual that holds the common stock as a capital asset and is present in the United States for 183 or more days in the taxable year of the sale or other disposition and certain other conditions are met, or (3) the company is or has been a U.S. real property holding corporation for U.S. federal income tax purposes at any time during the shorter of the five-year period ending on the date of disposition and the Non-U.S. Holder s holding period for the common stock.

An individual Non-U.S. Holder described in clause (1) above will be subject to tax on the net gain derived from the sale under regular graduated U.S. federal income tax rates. An individual Non-U.S. Holder described in clause (2) above will be subject to a flat 30% tax on the gain derived from the sale, which may be offset by U.S. source capital losses (even though the individual is not considered a resident of the U.S.). If a Non-U.S. Holder that is a foreign corporation falls under clause (1) above, it will be subject to tax on its gain under regular graduated U.S. federal income tax rates and, in addition, may be subject to the branch profits tax equal to 30% of its effectively connected earnings and profits or at such lower rate as may be specified by an applicable income tax treaty.

Our company believes it should not be and does not anticipate becoming a U.S. real property holding corporation for United States federal income tax purposes. However, if we are or become a U.S. real property holding corporation, then assuming the common stock is regularly traded on an established securities market, a Non-U.S. Holder who holds or held (at any time during the shorter of the five-year period ending on the date of disposition and the Non-U.S. Holder s holding period for the common stock) more than 5% of the common stock will be subject to U.S. federal income tax on the disposition of the common stock.

U.S. Estate Tax

Common stock held by an individual Non-U.S. Holder at the time of death will be included in such holder s gross estate for U.S. federal estate tax purposes, unless an applicable estate tax treaty provides otherwise.

Information Reporting and Backup Withholding

Our company must report annually to the IRS and to each Non-U.S. Holder the amount of dividends paid to that holder and the tax withheld with respect to those dividends, regardless of whether withholding was required. Copies of the information returns reporting those dividends and withholding may also be made available to the tax authorities in the country in which the Non-U.S. Holder resides under the provisions of an applicable income tax treaty.

A Non-U.S. Holder will be subject to backup withholding unless applicable certification requirements are met.

Proceeds of a sale of common stock paid within the United States or through certain U.S. related financial intermediaries are subject to both backup withholding and information reporting unless the beneficial owner certifies under penalties of perjury that it is a Non-U.S. Holder (and the payor does not have actual knowledge that the beneficial owner is a U.S. person), or the holder establishes another exemption.

Any amounts withheld under the backup withholding rules may be allowed as a refund or a credit against such holder s U.S. federal income tax liability if the required information is furnished to the IRS.

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UNDERWRITERS

Under the terms and subject to the conditions contained in an underwriting agreement dated the date of this prospectus, the underwriters named below, for whom Morgan Stanley & Co. Incorporated, Credit Suisse First Boston LLC, Deutsche Bank Securities Inc. and Goldman, Sachs & Co. are acting as representatives, have severally agreed to purchase, and we have agreed to sell to them, severally, the number of shares of our common stock indicated below:

Name	Number of Shares
Morgan Stanley & Co. Incorporated	
Credit Suisse First Boston LLC	
Deutsche Bank Securities Inc.	
Goldman, Sachs & Co.	
Total	11,500,000

The underwriters are offering the shares of common stock subject to their acceptance of the shares from us and subject to prior sale. The underwriting agreement provides that the obligations of the several underwriters to pay for and accept delivery of the shares of our common stock offered by this prospectus are subject to the approval of certain legal matters by their counsel and to certain other conditions. The underwriters are obligated to take and pay for all of the shares of common stock offered by this prospectus if any such shares are taken. However, the underwriters are not required to take or pay for the shares covered by the underwriters over-allotment option described below.

The underwriters initially propose to offer part of the shares of common stock directly to the public at the public offering price listed on the cover page of this prospectus and part to certain dealers at a price that represents a concession not in excess of $ a share under the public offering price. After the initial offering of the shares of common stock, the offering price and other selling terms may from time to time be varied by the representatives.

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 1,725,000 additional shares of common stock at the public offering price set forth on the cover page of this prospectus, less underwriting discounts and commissions. The underwriters may exercise this option solely for the purpose of covering over-allotments, if any, made in connection with the offering of the shares of common stock offered by this prospectus. To the extent the option is exercised, each underwriter will become obligated, subject to specified conditions, to purchase approximately the same percentage of the additional shares of common stock as the number listed next to the underwriter s name in the table above bears to the total number of shares set forth next to the names of all underwriters in that table.

If the underwriters option is exercised in full, the total price to the public would be $ million, the total underwriting discounts and commissions would be $ million and the total proceeds to us would be $ million.

The underwriters have informed us that they do not intend sales to discretionary accounts to exceed five percent of the total number of shares of common stock offered by them.

We, our directors and executive officers, Blackstone and Occidental, owning an aggregate of 36,469,406 shares, have agreed that, without the prior written consent of Morgan Stanley & Co. Incorporated on behalf of the underwriters, none of us will, during the period ending 90 days after the date of this prospectus:

offer, pledge, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of, directly or indirectly, any shares of common stock or any securities convertible into or exercisable or exchangeable for shares of common stock; or

enter into any swap or other arrangement that transfers to another, in whole or in part, any of the economic consequences of ownership of the common stock;

whether any such transaction described above is to be settled by delivery of common stock or such other securities, in cash or otherwise, or, in the case of our company, otherwise file a registration statement, other than a registration statement on Form S-8 covering shares of common stock subject to outstanding options or options to be issued under our stock option plans.

The restrictions described in this paragraph do not apply to:

the sale of shares of common stock to the underwriters;

the issuance by us of shares of common stock upon the exercise of an option or a warrant or the conversion of a security outstanding on the date of this prospectus of which the underwriters have been advised in writing;

the issuance of common stock or the grant of an option to purchase common stock under our stock plans described in this prospectus;

the issuance of common stock in connection with the acquisition of another company, if recipients of the common stock agree to be bound by the 90-day lock-up described above, and the filing of a registration statement with respect thereto; or

transactions by any person other than us relating to shares of common stock or other securities acquired in open market transactions after the completion of the offering of the shares.

In order to facilitate the offering of the common stock, the underwriters may engage in transactions that stabilize, maintain or otherwise affect the price of the common stock. Specifically, the underwriters may sell more shares than they are obligated to purchase under the underwriting agreement, creating a short position. A short sale is covered if the short position is no greater than the number of shares available for purchase by the underwriters under the over-allotment option. The underwriters can close out a covered short sale by exercising the over-allotment option or purchasing shares in the open market. In determining the source of shares to close out a covered short sale, the underwriters will consider, among other things, the open market price of shares compared to the price available under the over-allotment option. The underwriters may also sell shares in excess of the over-allotment option, creating a naked short position. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the common stock in the open market after pricing that could adversely affect investors who purchase in the offering. In addition, to cover any over-allotment or to stabilize the price of our common stock, the underwriters may bid for, and purchase, shares of common stock in the open market. Finally, the underwriting syndicate may also reclaim selling concessions allowed to an underwriter or a dealer for distributing common stock in transactions to cover syndicate short positions, in stabilization transactions or otherwise. Any of these activities may stabilize or maintain the market price of the common stock above independent market levels or prevent or retard a decline in the market price of our common stock. The underwriters are not required to engage in these activities, and may end any of these activities at any time.

A prospectus in electronic format may be made available on the websites maintained by one or more underwriters. The underwriters may agree to allocate a number of shares to underwriters for sale to their online brokerage account holders. Internet distributions will be allocated by the lead manager to underwriters that may make internet distributions on the same basis as other allocations.

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From time to time, some of the underwriters and their affiliates have provided, and may continue to provide, investment banking and commercial banking services to us for fees and commissions that we believe are customary. For example, the representatives will act as initial purchasers in our concurrent debt financing. Additionally, affiliates of Deutsche Bank Securities Inc. are participants in our existing credit facility, and we expect that affiliates of one or more of the underwriters will participate in our amended and restated credit facility. Affiliates of Morgan Stanley & Co. Incorporated have also committed to finance a portion of our acquisition of the Memphis refinery, if necessary, and are expected to enter into a crude oil supply and product off-take agreement with us. As part of the financing commitment, Morgan Stanley & Co. Incorporated will be offered a lead role in repayment or refinancing transactions with respect to funds provided to us under the commitment for three years from the date of this prospectus. This is deemed compensation by the NASD and is valued under NASD rules at 1% of the proceeds of the offering.

We and the underwriters have agreed to indemnify each other against certain liabilities, including liabilities under the Securities Act.

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LEGAL MATTERS

The validity of our common stock offered hereby and other legal matters will be passed upon for us by Stroock & Stroock & Lavan LLP, New York, New York. The validity of our common stock offered hereby will be passed upon for the underwriters by Davis Polk & Wardwell, New York, New York.

EXPERTS

The financial statements as of December 31, 2001 and 2000, and for each of the three years in the period ended December 31, 2001, included in this prospectus and the related financial statement schedules included elsewhere in the registration statement have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports appearing herein and elsewhere in the registration statement, and have been so included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

With respect to the unaudited interim financial information for the periods ended September 30, 2002 and 2001 included in this prospectus, Deloitte & Touche LLP have applied limited procedures in accordance with professional standards for a review of such information. However, as stated in their reports in our Quarterly Reports on Form 10-Q for the quarter ended September 30, 2002 and included in this prospectus, they did not audit and they do not express an opinion on that interim financial information. Accordingly, the degree of reliance on their reports on such information should be restricted in light of the limited nature of the review procedures applied. Deloitte & Touche LLP are not subject to the liability provisions of Section 11 of the Securities Act of 1933 for their reports on the unaudited interim financial information because those reports are not reports or a part of the registration statement prepared or certified by an accountant within the meaning of Sections 7 and 11 of the Securities Act.

WHERE YOU CAN FIND ADDITIONAL INFORMATION

We have filed with the Securities and Exchange Commission a registration statement on Form S-1 with respect to the common stock offered in this prospectus. This prospectus is a part of the registration statement and, as permitted by the Securities and Exchange Commission s rules, does not contain all of the information presented in the registration statement. Whenever a reference is made in this prospectus to one of our contracts or other documents, please be aware that this reference is not necessarily complete and that you should refer to the exhibits that are a part of the registration statement for a copy of the contract or other document. You may review a copy of the registration statement, including exhibits to the registration statement, at the Securities and Exchange Commission s public reference room at 450 Fifth Street, N.W, Washington, D.C. 20549. Please call the Securities and Exchange Commission at 1-800-SEC-0330 for further information on the operation of the public reference room. Our filings with the Securities and Exchange Commission are also available to the public through the Securities and Exchange Commission s internet site at http://www.sec.gov.

We are subject to the informational requirements of the Exchange Act, and in accordance with the Exchange Act have filed annual, quarterly and current reports and other information with the Securities and Exchange Commission. You may read and copy any documents filed by us at the address set forth above.

You may request copies of the filings, at no cost, by telephone at (203) 698-7500 or by mail at: Premcor Inc., 1700 East Putnam Avenue, Suite 500, Old Greenwich, Connecticut 06870, Attention: Investor Relations.

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GLOSSARY OF SELECTED TERMS

The following are definitions of certain terms used in this prospectus.

alkylation	A polymerization process uniting olefins and isoparaffins; particularly the reacting of butylene and isobutane, with sulfuric acid or hydrofluoric acid as a catalyst, to produce a high-octane, low-sensitivity blending agent for gasoline.
anode	A positively charged conductor that influences the flow of current in another conducting medium.
barrel	Common unit of measure in the oil industry which equates to 42 gallons.
blendstocks	Various compounds that are combined with gasoline from the crude oil refining process to make finished gasoline and diesel fuel; these may include natural gasoline, FCC unit gasoline, ethanol, reformate or butane, among others.
bpd	Abbreviation for barrels per day.
btu	British thermal units: a measure of energy. One btu of heat is required to raise the temperature of one pound of water one degree fahrenheit.
by-products	Products that result from extracting high value products such as gasoline and diesel fuel from crude oil; these include black oil, sulfur, propane, petroleum coke and other products.
catalyst	A substance that alters, accelerates, or instigates chemical changes, but is neither produced, consumed nor altered in the process.
coker gross margin	The value of refined products derived from coker feedstocks less the cost of such coker feedstocks.
coker unit	A refinery unit that utilizes the lowest value component of crude oil remaining after all higher value products are removed, further breaks down the component into more valuable products and converts the rest into petroleum coke.
crack spread	A simplified model that measures the difference between the price for light products and crude oil. For example, a 3/2/1 crack spread is often referenced and represents the approximate gross margin resulting from processing one barrel of crude oil, being three barrels of crude oil to produce two barrels of gasoline and one barrel of diesel fuel.
crude unit	The initial refinery unit to process crude oil by separating the crude oil according to boiling point under high heat and low pressure to recover various hydrocarbon fractions.
distillates	Primarily diesel fuel, kerosene and jet fuel.
feedstocks	Hydrocarbon compounds, such as crude oil and natural gas liquids, that are processed and blended into refined products.
fluid catalytic cracking unit	Converts gas oil from the crude unit or coker unit into liquefied petroleum gas, distillate and gasoline blendstocks by applying heat in the presence of a catalyst.
fractionator	A cylindrical vessel designed to distill or separate compounds that have different vapor pressures at any given temperature. Also called stabilizer column, fractionating tower or bubble tower.

heavy crude oil	A relatively inexpensive crude oil characterized by high relative density and viscosity. Heavy crude oils require greater levels of processing to produce high value products such as gasoline and diesel fuel.
hydrocracker unit	A refinery unit that converts low-value intermediates into gasoline, naphtha, kerosene and distillates under very high pressure in the presence of hydrogen and a catalyst.
independent refiner	A refiner that does not have crude oil exploration or production operations. An independent refiner purchases the crude oil used as feedstock in its refinery operations from third parties.
light crude oil	A relatively expensive crude oil characterized by low relative density and viscosity. Light crude oils require lower levels of processing to produce high value products such as gasoline and diesel fuel.
liquefied petroleum gas	Light hydrocarbon material gaseous at atmospheric temperature and pressure, held in the liquid state by pressure to facilitate storage, transport and handling.
lost time	see lost work day.
lost time injury	Any injury that results in one or more lost work days.
lost time injury rate	The number of lost time injuries per 200,000 hours worked.
lost work day	The number of workdays (consecutive or not) beyond the day of injury or onset of illness the employee was away from work or limited to restricted work activity because of an occupational injury or illness. (1) lost workdays away from work. The number of workdays (consecutive or not) on which the employee would have worked but could not because of occupational injury or illness. (2) lost workdays restricted work activity. The number of workdays (consecutive or not) on which, because of injury or illness: (i) the employee was assigned to another job on a temporary basis; or (ii) the employee worked at a permanent job less than full time; or (iii) the employee worked at a permanently assigned job but could not perform all duties normally connected with it. The number of days away from work or days of restricted work activity does not include the day of injury or onset of illness or any days on which the employee would not have worked even though able to work.
MTBE	Methyl Tertiary Butyl Ether, an ether produced from the reaction of isobutylene and methanol specifically for use as a gasoline blendstock. The EPA requires MTBE or other oxygenates to be blended into reformulated gasoline.
mbpd	thousand barrels per day.
Maya	A heavy, sour crude oil from Mexico characterized by an API gravity of approximately 21.5 and a sulfur content of approximately 3.6 weight percent.
merchant refiner	A refiner that is not vertically integrated to distribute its refinery products through branded retail outlets.
naphtha	The major constituent of gasoline fractionated from crude oil during the refining process, which is later processed in the reformer unit to increase octane.

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olefin cracker	A chemical processing plant designed to produce predominantly ethylene and propylene for use in the production of plastics and other chemicals.
PADD I	East Coast Petroleum Area for Defense District.
PADD II	Midwest Petroleum Area for Defense District.
PADD III	Gulf Coast Petroleum Area for Defense District.
PADD IV	Rocky Mountains Petroleum Area for Defense District.
PADD V	West Coast Petroleum Area for Defense District.
particulate matter	Material suspended in the air in the form of minute solid particles or liquid droplets, especially when considered as an atmospheric pollutant.
petroleum coke	A coal-like substance that can be burned to generate electricity or used as a hardener in concrete.
propylene	A commodity chemical, derived from petroleum hydrocarbon cracking processes, which is used in the production of plastics and other chemicals.
pure-play refiner	A refiner without either crude oil production operations or retail distribution operations (that is, both an independent and a merchant refiner).
pyrolysis gasoline or pygas	A high octane blendstock produced as a by-product from an olefin cracker.
rack marketing system	A network of assets designed to deliver transportation fuels into trucks to wholesale customers.
rated crude oil capacity	The crude oil processing capacity of a refinery that is established by engineering design.
recordable injury	An injury, as defined by OSHA. All work-related deaths and illnesses, and those work-related injuries which result in loss of consciousness, restriction of work or motion, transfer to another job, or require medical treatment beyond first aid.
recordable injury rate	The number of recordable injuries per 200,000 hours worked.
refined products	Hydrocarbon compounds, such as gasoline, diesel fuel, jet fuel and residual fuel, that are produced by a refinery.
refinery conversion	The ability of a refinery to produce high-value lighter refined products such as gasoline, diesel fuel and jet fuel from crude oil and other feedstocks.
reformer unit	A refinery unit that processes naphtha and converts it to high-octane gasoline by using a platinum/rhenium catalyst. Also known as a platformer.
reformulated gasoline	The composition and properties of which meet the requirements of the reformulated gasoline regulations.
single train	A refinery processing configuration consisting of only one crude unit and several downstream conversion units with no significant amount of redundancy in such units.
sour crude oil	A crude oil that is relatively high in sulfur content, requiring additional processing to remove the sulfur. Sour crude oil is typically less expensive than sweet crude oil.
spot market	A market in which commodities are bought and sold for cash and delivered immediately.

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sweet crude oil	A crude oil that is relatively low in sulfur content, requiring less processing to remove the sulfur. Sweet crude oil is typically more expensive than sour crude oil.
throughput	The volume per day processed through a unit or a refinery.
turnaround	A periodically required standard procedure to refurbish and maintain a refinery that involves the shutdown and inspection of major processing units and occurs every three to four years.
unbranded	A term used in connection with fuel or the sale of fuel into the spot or wholesale markets, rather than fuel or the sale of fuel directly to retail outlets.
utilization	Ratio of total refinery throughput to the rated capacity of the refinery.
WTI	West Texas Intermediate crude oil, a light, sweet crude oil, characterized by an API gravity between 38 and 40 and a sulfur content of approximately 0.3 weight percent that is used as a benchmark for other crude oils.
yield	The percentage of refined products that are produced from feedstocks.

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PREMCOR INC. AND SUBSIDIARIES

INDEX TO FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS REPORT

To the Board of Directors of Premcor Inc.:

We have audited the accompanying consolidated balance sheets of Premcor Inc. and subsidiaries (the Company) as of December 31, 2001 and 2000 and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2001 and 2000, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2001, in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

St. Louis, Missouri
February 11, 2002 (March 29, 2002 as to Note 15, April 15, 2002 as to Note 10 and 19 and August 5, 2002 as to Note 2)

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PREMCOR INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
(dollars in millions, except per share data)

	December 31,	
	2000	2001
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 290.1	$ 510.1
Short-term investments	1.7	1.7
Cash and cash equivalents restricted for debt service		30.8
Accounts receivable, net of allowance of $1.3 and $1.3	250.5	148.3
Inventories	378.3	318.3
Prepaid expenses and other	39.2	52.3
Total current assets	959.8	1,061.5
PROPERTY, PLANT AND EQUIPMENT, NET	1,348.3	1,299.6
OTHER ASSETS	161.0	148.7
	$ 2,469.1	$ 2,509.8
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 505.2	$ 366.4
Accrued expenses and other	89.7	95.4
Accrued taxes other than income	38.4	35.7
Current portion of long-term debt	1.5	81.4
Total current liabilities	634.8	578.9
LONG-TERM DEBT	1,514.5	1,391.4
DEFERRED INCOME TAXES		16.7
OTHER LONG-TERM LIABILITIES	65.7	109.1
COMMITMENTS AND CONTINGENCIES		
MINORITY INTEREST	11.4	24.2
EXCHANGEABLE PREFERRED STOCK OF SUBSIDIARY		
($0.01 par value per share; 250,000 shares authorized, 88,110 shares issued and outstanding in 2000 and 92,284 shares issued and outstanding in 2001)	90.6	94.8
COMMON STOCKHOLDERS EQUITY:		
Common, $0.01 par value per share, 53,000,000 authorized, 25,720,589 issued and outstanding in 2000 and in 2001; Class F Common, $0.01 par value, 7,000,000 authorized, 6,101,010 issued and outstanding in 2000 and 2001	0.3	0.3
Paid-in capital	323.7	323.7
Retained deficit	(171.9)	(29.3)
Total common stockholders equity	152.1	294.7
	$ 2,469.1	$ 2,509.8

The accompanying notes are an integral part of these statements.

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PREMCOR INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(dollars and shares in millions, except per share amount)

	For the Year Ended December 31,		
	1999	**2000**	**2001**
NET SALES AND OPERATING REVENUES	$ 4,520.5	$ 7,301.7	$ 6,417.5
EXPENSES:			
Cost of sales	4,099.8	6,562.5	5,251.4
Operating expenses	402.8	467.7	467.7
General and administrative expenses	51.5	53.0	63.3
Depreciation	36.1	37.1	53.2
Amortization	27.0	34.7	38.7
Inventory recovery from market write-down	(105.8)		
Refinery restructuring and other charges			176.2
	4,511.4	7,155.0	6,050.5
OPERATING INCOME	9.1	146.7	367.0
Interest and finance expense	(103.5)	(99.6)	(158.4)
Gain on extinguishment of long-term debt			8.7
Interest income	12.0	17.4	18.9
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST	(82.4)	64.5	236.2
Income tax (provision) benefit	12.0	25.8	(52.4)
Minority interest in subsidiary	1.4	(0.6)	(12.8)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(69.0)	89.7	171.0
Discontinued operations:			
Loss from operations, net of income tax benefit (1999 $2.7; 2001 $11.5)	(4.3)		(18.0)
Gain on disposal of discontinued operations, net of income tax provision of $23.7	36.9		
NET INCOME (LOSS)	(36.4)	89.7	153.0
Preferred stock dividends	(8.6)	(9.6)	(10.4)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$ (45.0)	$ 80.1	$ 142.6
Net income (loss) per common share			
Basic:			
Income (loss) from continuing operations	$ (3.59)	$ 2.79	$ 5.05
Discontinued operations	1.51		(0.57)
Net income (loss)	$ (2.08)	$ 2.79	$ 4.48
Weighted average common shares outstanding	21.6	28.8	31.8
Diluted:			
Income (loss) from continuing operations	$ (3.59)	$ 2.55	$ 4.65
Discontinued operations	1.51		(0.52)
Net income (loss)	$ (2.08)	$ 2.55	$ 4.13

Weighted average common shares outstanding	21.6	31.5	34.5

The accompanying notes are an integral part of these statements.

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PREMCOR INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(dollars in millions)

	For the Year Ended December 31,		
	1999	**2000**	**2001**
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	$ (36.4)	$ 89.7	$ 153.0
Discontinued operations	4.3		18.0
Adjustments:			
Depreciation	36.1	37.1	53.2
Amortization	34.6	45.5	50.3
Deferred income taxes	8.2	(24.2)	52.0
Gain on sale of retail division	(36.9)		
Inventory recovery from market write-down	(105.8)		
Minority interest	(1.4)	0.6	12.8
Refinery restructuring and other charges			118.5
Other, net	17.8	(0.2)	1.5
Cash provided by (reinvested in) working capital			
Accounts receivable, prepaid expenses and other	(66.0)	(54.6)	89.1
Inventories	122.6	(126.1)	60.0
Accounts payable, accrued expenses, taxes other than income, and other	133.6	156.6	(136.5)
Cash and cash equivalents restricted for debt service			(24.3)
Net cash provided by operating activities of continuing operations	110.7	124.4	447.6
Net cash used in operating activities of discontinued operations	(25.2)		(8.4)
Net cash provided by operating activities	85.5	124.4	439.2
CASH FLOWS FROM INVESTING ACTIVITIES:			
Expenditures for property, plant and equipment	(438.2)	(390.7)	(94.5)
Expenditures for turnaround	(77.9)	(31.5)	(49.2)
Cash and cash equivalents restricted for investment in capital additions	(46.6)	46.6	(9.9)
Proceeds from sale of assets	248.5	0.5	0.7
Equity investment in Clark Retail Enterprises	(5.0)		
Purchases of short-term investments	(3.2)	(1.7)	(1.7)
Sales and maturities of short-term investments	2.9	1.5	1.7
Discontinued operations	(1.8)		
Net cash used in investing activities	(321.3)	(375.3)	(152.9)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of long-term debt	360.0	182.6	10.0
Repurchase of long-term debt			(57.8)
Cash and cash equivalents restricted for debt repayment			(6.5)
Proceeds from issuance of common stock	61.0	57.3	
Contribution from minority interest	5.7	6.5	
Repurchase of common stock	(3.6)		
Capital lease payments	(3.3)	(7.3)	(1.5)
Deferred financing costs	(25.9)	(4.3)	(10.2)
Preferred stock dividend			(0.3)
Net cash provided by (used in) financing activities	393.9	234.8	(66.3)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	158.1	(16.1)	220.0
CASH AND CASH EQUIVALENTS, beginning of period	148.1	306.2	290.1

CASH AND CASH EQUIVALENTS, end of period	$ 306.2	$ 290.1	$ 510.1

The accompanying notes are an integral part of these statements.

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PREMCOR INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
(dollars in millions)

	Common Stock		Class F Common			
	Shares	Par Value	Shares	Par Value	Additional Paid-In Capital	Retained Earnings (Accumulated Deficit)
BALANCE, December 31, 1998	13,767,829	$ 0.1	6,101,010	$ 0.1	$ 209.0	$ (207.0)
Net loss						(45.0)
Stock issuance	6,076,060	0.1			61.0	
Redemption of common stock					(3.6)	
BALANCE, December 31, 1999	19,843,889	0.2	6,101,010	0.1	266.4	(252.0)
Net income						80.1
Stock issuance	5,876,700				57.3	
BALANCE, December 31, 2000	25,720,589	0.2	6,101,010	0.1	323.7	(171.9)
Net income						142.6
BALANCE, December 31, 2001	25,720,589	$ 0.2	6,101,010	$ 0.1	$ 323.7	$ (29.3)

The accompanying notes are an integral part of these statements.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended December 31, 1999, 2000 and 2001
(Tabular dollar amounts in millions of US dollars)

1. Nature of Business

Premcor Inc. (individually, Premcor Inc. and collectively with its subsidiaries, the Company), a Delaware corporation was incorporated in April 1999. The Company comprises one of the largest independent petroleum refiners and suppliers of unbranded transportation fuels, heating oil, petrochemical feedstocks, petroleum coke and other petroleum products in the United States. The Company owns and operates three refineries with a combined crude oil throughput capacity of 490,000 barrels per day (bpd). Our refineries are located in Port Arthur, Texas; Lima, Ohio; and Hartford, Illinois. The Company was formed pursuant to a share exchange agreement wherein all shares of Premcor USA Inc. (Premcor USA), were exchanged on a one-for-one basis for the shares of the Company. Premcor Inc. s common equity is privately held and controlled by Blackstone Capital Partners III Merchant Banking Fund L.P. and its affiliates (Blackstone) through its current voting interest of 80.2%. The Company s other principal shareholder is a subsidiary of Occidental Petroleum Corporation (Occidental) with a current voting interest of 18.4%. Blackstone and Occidental exchanged their shares of Premcor USA for Premcor Inc. shares in May 1999 to facilitate the construction and financing of a heavy oil upgrade project as described below.

Premcor Inc. owns all of the outstanding common stock of Premcor USA and 90% of the outstanding common stock of Sabine River Holding Corp. (Sabine). Occidental owns the remaining 10% of the outstanding common stock of Sabine. The consolidated financial statements and footnotes represent the results of operations of Premcor USA and its subsidiaries through April 27, 1999 as the predecessor company of Premcor Inc.

Premcor USA, a Delaware corporation, was incorporated in 1988 as AOC Holdings, Inc. Its principal operating subsidiary is The Premcor Refining Group Inc. (PRG), a Delaware corporation formed in 1988 as Clark Oil & Refining Corporation. Premcor USA and the PRG changed their names in May 2000 after selling the Clark trade name as part of the sale of their retail division in July 1999. Since Premcor USA s retail division was sold in 1999, the retail marketing operating results are segregated and reported as discontinued operations in the accompanying consolidated statements of operations and cash flows.

Sabine, a Delaware corporation, was incorporated in May 1999 and capitalized in August 1999. Its principal operating subsidiary is Port Arthur Coker Company L.P. (PACC). Sabine and PACC were formed to develop, construct, own, operate and finance a heavy oil processing facility that includes an 80,000 barrel per stream day delayed coking unit, a 35,000 barrel per stream day hydrocracker, a 417 long tons per day sulfur complex and related assets at PRG s Port Arthur, Texas refinery (the heavy oil upgrade project). The heavy oil upgrade project became fully operational in January of 2001 and reached what is defined in the construction contract and financing documents as substantial reliability in September of 2001. Final completion of this project was achieved on December 28, 2001.

On September 27, 2001, the Company filed a registration statement on Form S-1 under the Securities Act of 1933, as amended, with the United States Securities and Exchange Commission in connection with a proposed initial public offering of its common stock. The Company retained Morgan Stanley & Co. Incorporated as the lead underwriter of this offering. Earlier in the year, the Company had retained the investment firm Credit Suisse First Boston and The Blackstone Group L.P. to serve as its financial advisors to assist the Company in its review of alternatives to maximize the value of the Company. No assurance was given that this review would result in any specific transaction. At the current time, the Company is not actively pursuing a specific transaction to maximize its value other than the proposed initial public offering of its common stock.

All of the operations of Premcor USA and Sabine are in the United States. These operations are related to the refining of crude oil and other petroleum feedstocks into petroleum products and are all considered part of

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

one business segment. The Company s earnings and cash flows from operations are primarily dependent upon processing crude oil and selling quantities of refined petroleum products at margins sufficient to cover operating expenses. Crude oil and refined petroleum products are commodities, and factors largely out of the Company s control can cause prices to vary, in a wide range, over a short period of time. This potential margin volatility can have a material effect on the financial position, current period earnings, and cash flows.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Premcor USA and Sabine. Through Sabine, the consolidated financial statements include the accounts of Sabine s wholly owned subsidiary Neches River Holding Corp. (Neches), and through Neches s 99% limited partnership interest and Sabine s 1% general partnership interest in PACC, 100% of PACC and PACC s wholly owned subsidiary, Port Arthur Finance Corp. (PAFC). Through Premcor USA, the consolidated financial statements include the accounts of The Premcor Pipeline Co. and PRG, including its wholly owned subsidiaries Premcor P.A. Pipeline Company and Premcor Investments Inc.

The Company consolidates the assets, liabilities, and results of operations of subsidiaries in which the Company has a controlling interest. Investments in companies in which the Company owns 20 percent to 50 percent voting control are accounted for by the equity method, and investments in companies in which the Company owns less than 20 percent voting control are accounted for by the cost method. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the dates of financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments, such as time deposits, money market instruments, commercial paper and United States and foreign government securities, purchased with an original maturity of three months or less, to be cash equivalents.

Revenue Recognition

Revenue from sales of products is recognized upon transfer of title, based upon the terms of delivery.

Supply and Marketing Activities

The Company engages in the buying and selling of crude oil to supply its refineries. Purchases of crude oil are recorded in cost of sales . Sales of crude oil where the Company bears risk on market price, timing, and other non-controllable factors are recorded in net sales and operating revenue ; otherwise, the sales of crude oil are recorded against cost of sales . The Company also engages in the buying and selling of refined products to facilitate the marketing of its refined product production. The results of this activity are recorded in cost of sales

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and sales. Our distribution network is an integral part of our refining business. However, due to ordinary course logistical issues concerning production schedules and product sales commitments, it is common for us to purchase refined products from third parties in order to balance the requirements of our product marketing activities. Although third party purchases are essential to effectively market our production, the effects from these activities on our operating results are not significant.

Refined product exchange transactions that do not involve the payment or receipt of cash are not accounted for as purchases or sales. Any resulting volumetric exchange balances are accounted for as inventory in accordance with the last-in, first-out (LIFO) inventory method for Premcor USA and the first-in, first-out (FIFO) inventory method for Sabine. Exchanges that are settled through payment or receipt of cash are accounted for as purchases or sales.

Excise Taxes

The Company collects excise taxes on sales of gasoline and other motor fuels. Excise taxes of approximately $451.0 million, $471.1 million, and $386.0 million were collected from customers and paid to various governmental entities in 2001, 2000, and 1999, respectively. Excise taxes are not included in sales.

Inventories

Inventories for the Company are stated at the lower of cost or market. Cost is determined under the LIFO method for Premcor USA for hydrocarbon inventories including crude oil, refined products, and blendstocks. Sabine determines cost under the FIFO method for hydrocarbon inventories including crude oil and refined products. The cost of warehouse stock and other inventories for Premcor USA and Sabine is determined under the FIFO method. Any reserve for inventory cost in excess of market value is reversed if physical inventories turn and prices recover above cost.

Hedging Activity

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedge Activities*, as amended, effective January 1, 2001. The adoption of SFAS No. 133 did not have a material impact on the Company s financial position or results of operations because the Company has historically marked to market all financial instruments used in the implementation of the Company s hedging strategies. The Company considers all futures and options contracts to be part of its risk management strategy. Unrealized gains and losses on open contracts are recognized in current cost of sales unless the contract can be identified as a price risk hedge of specific inventory positions or open commitments, in which case hedge accounting is applied under the provisions of SFAS No. 133.

Property, Plant, and Equipment

Property, plant, and equipment additions are recorded at cost. Depreciation of property, plant, and equipment is computed using the straight-line method over the estimated useful lives of the assets or group of assets, beginning for all Company-constructed assets in the month following the date in which the asset first achieves its design performance. The Company capitalizes the interest cost associated with major construction projects based on the effective interest rate on aggregate borrowings.

Expenditures for maintenance and repairs are expensed as incurred. Expenditures for major replacements and additions are capitalized. Upon disposal of assets depreciated on an individual basis, the gains and losses are

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

reflected in current operating income. Upon disposal of assets depreciated on a group basis, unless unusual in nature or amount, residual cost less salvage is charged against accumulated depreciation.

The Company reviews long-lived assets for impairments whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If the undiscounted future cash flows of an asset to be held and used in operations is less than the carrying value, the Company would recognize a loss for the difference between the carrying value and fair market value.

Deferred Turnaround

A turnaround is a periodically required standard procedure for maintenance of a refinery that involves the shutdown and inspection of major processing units which occurs approximately every three to five years. Turnaround costs include actual direct and contract labor, and material costs incurred for the overhaul, inspection, and replacement of major components of refinery processing and support units performed during turnaround. Turnaround costs, which are included in the Company s balance sheet in Other Assets, are currently amortized on a straight-line basis over the period until the next scheduled turnaround, beginning the month following completion. The amortization of the turnaround costs is presented as Amortization in the consolidated statements of operations.

The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants has issued an exposure draft of a proposed statement of position (SOP) entitled *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. If adopted as proposed, this SOP will require companies to expense as incurred turnaround costs, which it terms as the non-capital portion of major maintenance costs. Adoption of the proposed SOP would require that any existing unamortized turnaround costs be expensed immediately. If this proposed change were in effect at December 31, 2001, the Company would have been required to write-off unamortized turnaround costs of approximately $98 million. Unamortized turnaround costs will change in 2002 as maintenance turnarounds are performed and past maintenance turnarounds are amortized. If adopted in its present form, charges related to this proposed change would be taken in the first quarter of 2003 and would be reported as a cumulative effect of an accounting change, net of tax, in the consolidated statements of operations.

Environmental Costs

Environmental liabilities and reimbursements for underground storage remediation are recorded on an undiscounted basis when environmental assessments and/or remedial efforts are probable and can be reasonably estimated. Environmental expenditures that relate to current or future revenues are expensed or capitalized as appropriate. Expenditures that relate to an existing condition caused by past operations and that do not contribute to current or future revenue generation are expensed. Subsequent adjustments to estimates, to the extent required, may be made as more refined information becomes available.

Income Taxes

The Company provides for deferred taxes under the asset and liability approach, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred taxes are classified as current or noncurrent depending on the classification of the assets and liabilities to which the temporary differences relate. Deferred taxes arising from temporary differences that are not related to a specific asset or liability are classified as current or noncurrent depending on the periods in which the temporary differences are

PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

expected to reverse. The Company records a valuation allowance if it is more likely than not that some portion or all of net deferred tax assets will not be realized by the Company.

Stock Based Compensation Plan

The Company accounts for stock-based compensation issued to employees in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB Opinion No. 25) which generally requires recognizing compensation cost based upon the intrinsic value at the date granted of the equity instrument awarded. The Financial Accounting Standards Board (FASB) issued SFAS No. 123, *Accounting for Stock-Based Compensation*, which encourages, but does not require, companies to recognize compensation expense for grants of stock, stock options and other equity instruments based on the fair value of those instruments, but alternatively allows companies to disclose such impact in their footnotes. The Company has elected to adopt the footnote disclosure method of SFAS No. 123.

Earnings Per Share

Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding for the year. In arriving at net income available to common stockholders, preferred stock dividends were deducted in each year presented. Diluted earnings per share reflects the potential dilution that could occur if all outstanding warrants are exercised. The diluted earnings per share exclude shares related to employee stock options due to their antidilutive effect. These shares were antidilutive because the exercise price of the options was the same or greater than the average market price of the common shares.

New Accounting Standards

In June 2001, the FASB issued SFAS No. 141 *Business Combinations* and SFAS No. 142 *Goodwill and Other Intangible Assets*. SFAS No. 141, effective on issuance, requires business combinations initiated after June 30, 2001 to be accounted for using the purchase method of accounting and addresses the initial recording of intangible assets separate from goodwill. SFAS No. 142 requires that goodwill and intangible assets with indefinite lives will not be amortized, but will be tested at least annually for impairment. Intangible assets with finite lives will continue to be amortized. SFAS No. 142 is effective for fiscal years beginning after December 15, 2001. The implementation of SFAS No. 141 and SFAS No. 142 are not expected to have a material impact on our financial position and results of operations.

In July 2001, the FASB approved SFAS No. 143 *Accounting for Assets Retirement Obligations.* SFAS No. 143 addresses when a liability should be recorded for asset retirement obligations and how to measure this liability. The initial recording of a liability for an asset retirement obligation will require the recording of a corresponding asset which will be required to be amortized. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The implementation of SFAS No. 143 is not expected to have a material impact on the Company s financial position or results operations.

In August 2001, the FASB issued SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* and the accounting and reporting provisions of APB Opinion No. 30, *Reporting the Results of Operations Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, for the disposal of a segment of a business (as

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

previously defined in that Opinion). The provisions of this statement are effective for financial statements issued for fiscal years beginning after December 15, 2001, and interim periods within those fiscal years, with early application encouraged. The implementation of SFAS No. 144 is not expected to have a material impact on the Company s financial position or results of operations.

Gain on Extinguishment of Long-Term Debt

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections*. SFAS 145 rescinds SFAS No. 4, *Reporting Gains and Losses from the Extinguishment of Debt*; SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers*; and SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements*. SFAS No. 145 also amends SFAS No. 13, *Accounting for Leases*, as it relates to sale-leaseback transactions and other transactions structured similar to a sale-leaseback as well as amends other pronouncements to make various technical corrections. The provisions of SFAS No. 145 as they relate to the rescission of SFAS No. 4 shall be applied in fiscal years beginning after May 15, 2002. The provision of this statement related to the amendment to SFAS No. 13 shall be effective for transactions occurring after May 15, 2002. All other provisions of this statement shall be effective for financial statements on or after May 15, 2002. In the second quarter of 2002, as permitted by the pronouncement, the Company has elected early adoption of SFAS No. 145. Accordingly, the Company has included the gain on extinguishment of long-term debt in Income from continuing operations as opposed to as an extraordinary item, net of taxes, below Income from continuing operations in its Statement of Operations.

Reclassifications

Certain reclassifications have been made to prior years financial statements to conform to classifications used in the current year.

3. Refinery Restructuring and Other Charges

Refinery restructuring and other charges consisted of a $167.2 million charge related to the January 2001 closure of the Company s Blue Island, Illinois refinery and a $9.0 million charge related to the write-off of idled coker units at the Port Arthur refinery.

Blue Island Closure

In January 2001, the Company ceased operations at the Blue Island refinery due to economic factors and a decision that the capital expenditures necessary to produce low sulfur transportation fuels required by recently adopted Environmental Protection Agency regulations could not produce acceptable returns on investment. This closure resulted in a pretax charge of $167.2 million in 2001. The Company continues to utilize its petroleum products storage facility at the refinery site to supply selected products to the Chicago and other Midwest markets from the Company s operating refineries. Since the Blue Island refinery operation had been only marginally profitable in recent years and since we will continue to operate a petroleum products storage and distribution business from the Blue Island site, our reduced refining capacity resulting from the closure is not expected to have a significant negative impact on net income or cash flow from operations. The only significant effect on net income and cash flow will result from the actual shutdown process and subsequent environmental site remediation as discussed below. Unless there is a need to adjust the closure reserve in the future, there should be no significant effect on net income beyond 2001.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Management adopted an exit plan that detailed the shutdown of the process units at the refinery and the subsequent environmental remediation of the site. The shutdown of the process units was completed during the first quarter of 2001. The Company is currently in discussions with federal, state, and local governmental agencies concerning an investigation of the site and a remediation program that would allow for redevelopment of the site for other manufacturing uses at the earliest possible time. Until the investigation is completed and the site remediation plan is finalized, it is not possible to estimate the completion date for remediation, but the Company anticipates that the remediation activities will continue for an extended period of time.

A pretax charge of $150.0 million was recorded in the first quarter of 2001 and an additional charge of $17.2 million was recorded in the third quarter of 2001. The original charge included $92.5 million of non-cash asset write-offs in excess of realizable value and a reserve for future costs of $57.5 million, consisting of $12.0 million for severance, $26.4 million for the ceasing of operations, preparation of the plant for permanent closure and equipment remediation, and $19.1 million for site remediation and other environmental matters. The third quarter charge of $17.2 million included an adjustment of $5.6 million to the asset write-off to reflect changes in realizable asset value and an increase of $11.6 million related to an evaluation of expected future expenditures as detailed below. The Company expects to spend approximately $16 million in 2002 related to the remaining $36.5 million reserve for future costs, with the majority of the remainder to be spent over the next several years. The following schedule summarizes the restructuring reserve balance and net cash activity as of December 31, 2001:

	Initial Reserve	Reserve Adjustment	Net Cash Outlay	Reserve as of December 31, 2001
Employee severance	$ 12.0	$ 0.7	$ 10.6	$ 2.1
Plant closure/equipment remediation	26.4	6.3	18.8	13.9
Site clean-up/environmental matters	19.1	4.6	3.2	20.5
	$ 57.5	$ 11.6	$ 32.6	$ 36.5

The site clean-up and environmental reserve takes into account costs that are reasonably foreseeable at this time. As the site remediation plan is finalized and work is performed, further adjustments of the reserve may be necessary. In the second quarter of 2002, the Company expects to finalize procurement of environmental risk insurance policies which allow it to better estimate and, within the limits of the policy, cap its cost to remediate the site, and provide insurance coverage from future third party claims arising from past or future environmental releases. The Company expects to finalize this coverage in the second quarter of 2002. The Company believes this insurance program also provides the governmental agencies assurance that, once begun, remediation of the site will be completed in a timely and prudent manner.

The Blue Island refinery employed 297 employees, both hourly (covered by collective bargaining agreements) and salaried, the employment of 293 of whom was terminated during 2001.

Port Arthur Refinery Assets

In September 2001, the Company incurred a charge of $5.8 million related to the write-off of the net asset value of the idled coker units at the Port Arthur refinery. The Company has determined that an alternative use of the coker units is not probable at this time. The Company also accrued $3.2 million for future environmental clean-up costs related to the site.

4. Acquisitions and Dispositions

In December 1999, the Company sold 15 refined product terminals to Motiva Enterprises L.L.C., Equilon Enterprises L.L.C. (Equilon) and a subsidiary of Equilon for net cash proceeds of approximately $34 million.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company now has exchange and throughput agreements with an affiliate of the buyer at many of these terminal locations as well as new locations for the distribution of refined products.

In July 1999, the Company sold its retail marketing division to Clark Retail Enterprises (CRE) for net cash proceeds of $215 million. The Company holds approximately a five percent equity interest in CRE after acquiring an interest as part of the transaction. The retail marketing division sold included all Company and independently operated Clark branded stores and the Clark trade name. In general, the buyer assumed unknown environmental liabilities at the retail stores they acquired up to $50,000 per site, as well as responsibility for any post closing contamination. Subject to certain risk sharing arrangements, the Company retained responsibility for all pre-existing, known contamination. The retail marketing operations were classified as a discontinued operation and the results of operations were excluded from continuing operations in the consolidated statements of operations and statements of cash flows. The net sales revenue from the retail marketing operation for the year ended December 31, 1999 was $485.1 million.

In 2001, the Company recorded an additional pretax charge of $29.5 million (net of income taxes $18.0 million) related to the environmental and other liabilities of the discontinued retail operations. In the first quarter of 2001, the Company recorded a charge of $14.0 million representing a change in estimate relative to the Company s clean up obligation regarding the previously discontinued retail operations. In the fourth quarter of 2001, the Company recorded an additional environmental charge of $14.0 million, which was also a change in estimate concerning the amount collectible from state agencies under various reimbursement programs. More complete information concerning site by site clean up plans, changing postures of state regulatory agencies, and fluctuations in the amounts available under the state reimbursement programs prompted the change in estimates. The charge also included $1.5 million for workers compensation and general liability claims related to the discontinued retail operations.

5. Financial Instruments

Short-term Investments

Short-term investments include United States government security funds, maturing between three and twelve months from date of purchase. The Company invests only in AA-rated or better fixed income marketable securities or the short-term rated equivalent. The Company s short-term investments are all considered available-for-sale and are carried at fair value. Realized gains and losses are presented in Interest income and are computed using the specific identification method. As of December 31, 2001, short-term investments consisted of United States government debt securities of $1.7 million and were pledged as collateral for the Company s self-insured workers compensation programs (2000 $1.7 million). For the years ended December 31, 1999, 2000 and 2001, there were no material unrealized or realized gains or losses on short-term investments.

Fair Value Financial Instruments

The carrying amount of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term nature of these items. See Note 10 Long-Term Debt for disclosure of fair value of long-term debt.

Derivative Financial Instruments

The Company enters into crude oil and refined products futures and options contracts to limit risk related to hydrocarbon price fluctuations created by a potentially volatile market. As of December 31, 2001, the Company s open futures contracts represented 7.9 million barrels of crude oil and refined products, and had

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

terms extending into October 2002. These contracts reflected a contract value of $175.2 million and a fair market value of $167.5 million. The weighted average price for these future contracts in 2001 was $22.17 per barrel. As of December 31, 2000, the Company s open futures contracts represented 4.8 million barrels of crude oil and refined products and had terms extending into January 2002. These contracts reflected a contract value of $142.4 million and a fair market value of $140.0 million. The weighted average price for these futures contracts was approximately $29.72 per barrel.

As of December 31, 2001, the Company s open options contracts represented 1.2 million barrels of crude oil and refined products, and had terms extending into March 2002. These contracts reflected a contract value of $1.7 million and a fair market value of $0.9 million with a weighted average price of $1.42 per barrel. As of December 31, 2000, the Company s open option contracts represented 1.2 million barrels of crude oil and refined products and had terms extending into December 2001. These contracts reflected a contract value of $4.7 million and a fair market value of $4.3 million with a weighted average price of $3.92 per barrel. The net unrealized gains or losses on the futures and options contracts were recognized as a component of operating income since the Company has not elected hedge accounting for these contracts.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of trade receivables. Credit risk on trade receivables is minimized as a result of the credit quality of the Company s customer base and industry collateralization practices. The Company conducts ongoing evaluations of its customers and requires letters of credit or other collateral as appropriate. Trade receivable credit losses for the three years ended December 31, 2001 were not material.

The Company currently has a supply agreement with CRE, and the Company s billings to CRE totaled $813.8 million in 2001 of which $648.3 million were product sales and $165.5 million were federal excise and state motor fuel taxes that the Company collected and then remitted to governmental agencies (2000 total billings of $1,224.9 million, product sales of $972.0 million, federal excise and state motor fuel taxes of $252.9 million; 1999 total billings of $482.5 million, product sales of $355.9 million, federal excise and state motor fuel taxes of $126.6 million). The taxes were not included in Net sales and operating revenue, Cost of sales, or Operating expenses. The Company had a receivable of $7.4 million due from CRE as of December 31, 2001 (2000 $33.1 million).

The Company does not believe that it has a significant credit risk on its derivative instruments which are transacted through the New York Mercantile Exchange or with counterparties meeting established collateral and credit criteria.

6. Inventories

The carrying value of inventories consisted of the following:

	December 31,	
	2000	2001
Crude oil	$ 169.9	$ 77.0
Refined products and blendstocks	184.7	218.7
Warehouse stock and other	23.7	22.6
	$ 378.3	$ 318.3

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Inventories recorded under LIFO include crude oil, refined products, and blendstocks of $297.6 million and $252.6 million for the years ended December 31, 2000 and 2001, respectively. A LIFO liquidation reduced the Company s pretax earnings by $19.3 million in 2001. The 2001 liquidation was due to the closure of the Blue Island refinery and the decrease in the amount of crude oil processed by PRG at the Port Arthur refinery as Sabine became the predominant crude oil processor at the refinery. A LIFO liquidation increased pretax earnings by $54.6 million in 1999 due to an overall reduction in refining-related inventories and the sale of the retail marketing operations.

As of December 31, 2001, the market value of crude oil, refined product, and blendstock inventories was approximately $4.9 million above carrying value (2000 $100.8 million).

7. Property, Plant, and Equipment

Property, plant, and equipment consisted of the following:

	December 31, 2000	December 31, 2001
Real property	$ 8.3	$ 8.3
Process units, buildings, and oil storage and movement	833.1	1,344.3
Office equipment, furniture, and autos	23.3	24.4
Construction in progress	698.8	121.8
Accumulated depreciation	(215.2)	(199.2)
	$ 1,348.3	$ 1,299.6

The useful lives on depreciable assets used to determine depreciation were as follows:

Process units, buildings, and oil storage and movement	15 to 40 years; average 27 years
Office equipment, furniture and autos	3 to 12 years; average 7 years

Construction in progress included $646 million and $33 million related to the heavy oil upgrade project at the Port Arthur refinery as of December 31, 2000 and 2001, respectively.

8. Other Assets

Other assets consisted of the following:

	December 31, 2000	December 31, 2001
Deferred financing costs	$ 35.1	$ 32.6
Deferred turnaround costs	94.1	97.9
Deferred tax asset (see Note 14 Income Taxes)	23.8	
Investment in affiliate	4.3	4.3
Cash restricted for investment in capital additions		9.9
Other	3.7	4.0
	$ 161.0	$ 148.7

The Company incurred deferred financing costs in 2001 of $10.2 million (2000 $4.3 million, 1999 $7.5 million) associated with the amendment of its working capital facility at PRG and the issuance of tax exempt

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

bonds through the state of Ohio. Premcor USA and PRG wrote-off $0.6 million of their deferred financing costs related to the repurchase of a portion of their senior notes in September 2001 (see Note 10 Long-Term Debt). In 2001, related to the adoption of SFAS No. 133, PACC recorded its interest rate cap on its bank senior loan agreement at fair market value resulting in the write-down of deferred financing costs of $0.7 million.

Amortization of deferred financing costs for the year ended December 31, 2001 was $11.4 million (2000 $11.0 million, 1999 $7.4 million) and was included in Interest and finance expense .

Cash restricted for investment in capital additions is related to the outstanding proceeds from the Series 2001 Ohio Bonds (see Note 10 Long Term Debt). These proceeds are restricted to fund capital expenditure projects for solid waste and wastewater facilities at the Lima, Ohio refinery.

9. Working Capital Facilities

In August 2001, PRG amended and restated its secured revolving credit facility for a period of two years through August 2003. This new credit agreement provides for the issuance of letters of credit of up to the lesser of $650 million or the amount available under a borrowing base calculated with respect to cash and eligible cash equivalents, eligible investments, eligible receivables, eligible petroleum inventories, paid but unexpired letters of credit, and net obligations on swap contracts. PRG uses the facility primarily for the issuance of letters of credit to secure purchases of crude oil. As of December 31, 2001, $295.3 million (2000 $377.3 million) of the line of credit was utilized for letters of credit, of which $139.9 million supported deliveries that PRG had not taken title to at December 31, 2001, but had made a purchase commitment. The remaining $155.4 million related to deliveries in which the Company had taken title and accordingly recorded to inventory and accounts payable as well as a portion of letters of credit related to nonhydrocarbons.

PRG s credit agreement contains covenants and conditions that, among other things, limit dividends, indebtedness, liens, investments and contingent obligations. It also requires that PRG maintain its property and insurance, pay all taxes, comply with all applicable laws, and provide periodic information to, and conduct periodic audits on behalf of the lenders. PRG is also required to comply with certain financial covenants including the maintenance of working capital of at least $150 million, the maintenance of tangible net worth of at least $150 million, the maintenance of minimum levels of balance sheet cash as defined in the agreement of at least $75 million at all times and a cumulative cash flow test that from July 1, 2001 must not be less than zero. The credit agreement also limits the amount of future additional indebtedness that may be incurred by PRG subject to certain exceptions. Direct cash borrowings under the credit facility are limited to $50 million. There were no direct cash borrowings under the facility as of December 31, 2001 and 2000.

In December 2001, PRG entered into a $20 million cash-collateralized credit facility expiring August 23, 2003. This facility was arranged in order for PRG to receive a first year interest rate of 2% on its Series 2001 Ohio Bonds (see Note 10 Long-Term Debt). In addition, this facility can be utilized for other non-hydrocarbon purposes. As of December 31, 2001, $10.1 million of the line of credit was utilized for letters of credit related to the Series 2001 Ohio Bonds.

PAFC has a $35 million working capital facility which is primarily used for the issuance of letters of credit for the purchases of crude oil other than the Maya crude oil to be received under a long-term crude oil supply agreement with PMI Comercio Internacional, S.A. de C.V (PEMEX), an affiliate of Petroleos Mexicanos, the Mexican state oil company. As of December 31, 2001, none of the line of credit was utilized for letters of credit (2000 $29.3 million).

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In order to provide security to PEMEX for PACC s obligation to pay for shipments of Maya crude oil under the long-term crude oil supply agreement, PACC obtained from Winterthur International Insurance Company Limited (Winterthur), an oil payment guaranty insurance policy for the benefit of PEMEX. This oil payment guaranty insurance policy is in the amount of $150 million and will be a source of payment to PEMEX if PACC fails to pay PEMEX for one or more shipments of Maya crude oil. Under the senior debt documents, any payments by Winterthur on this policy are required to be reimbursed by PACC. This reimbursement obligation to Winterthur has an equal and ratable claim on all of the collateral for holders of PACC s senior debt, except in specified circumstances in which it has a senior claim to these parties. As of December 31, 2001, $79.5 million (2000 $62.1 million) of crude oil purchase commitments were outstanding related to this policy.

Under senior debt covenants, PACC was required to establish a debt service reserve account and at the time the heavy oil upgrade processing facility achieved substantial reliability, deposit or cause the deposit of an amount equal to the next semiannual payment of principal and interest. In lieu of depositing funds into this reserve account at substantial reliability, PACC arranged for Winterthur to provide a separate debt service reserve insurance policy in the maximum amount of $60 million for a period of approximately five years from substantial reliability of the heavy oil processing facility. Payments will be made under this policy to pay debt service to the extent that PACC does not have sufficient funds available to make a debt service payment on any scheduled semiannual payment date during the term of the policy. The term of the policy commenced at substantial reliability of the heavy oil processing facility and ends on the tenth semiannual payment date after substantial reliability, unless it terminates early because the debt service reserve account is funded to the required amount. The maximum liability of Winterthur under its policy is reduced as PACC makes deposits into the debt service reserve account. On the sixth semiannual payment date after substantial reliability, and on each of the next four semiannual payment dates, PACC is required to deposit, out of available funds for that purpose, $12 million into the debt service reserve account. Under a secured account structure (See Note 10 Long-Term Debt), until the debt service reserve account contains the required amount, PACC is required to make deposits into the debt service reserve account equal to all of PACC s excess cash flow that remains after PACC applies 75% of excess cash flow to prepay the bank senior loan agreement. Once the debt service reserve account contains the required amount, the Winterthur policy will terminate.

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10. Long-Term Debt

	December 31,	
	2000	**2001**
8 5/8% Senior Notes due August 15, 2008 (8 5/8% Senior Notes)(1)	$ 109.8	$ 109.8
8 3/8% Senior Notes due November 15, 2007 (8 3/8% Senior Notes)(1)	99.5	99.6
8 7/8% Senior Subordinated Notes due November 15, 2007 (8 7/8% Senior Subordinated Notes)(1)	174.1	174.2
Floating Rate Term Loan due November 15, 2003 and 2004 (Floating Rate Loan)(1)	240.0	240.0
9½% Senior Notes due September 15, 2004 (9½% Senior Notes)(1)	171.7	150.4
10 7/8% Senior Notes due December 1, 2005(10 7/8% Senior Notes)(2)	175.0	144.4
12½% Senior Secured Notes due January 15, 2009(12½% Senior Notes)(3)	255.0	255.0
Bank Senior Loan Agreement (3)	287.6	287.6
Ohio Water Development Authority Environmental Facilities Revenue Bonds due December 1, 2031(Series 2001 Ohio bonds)		10.0
Obligations under capital leases(1)	3.3	1.8
	1,516.0	1,472.8
Less current portion	1.5	81.4
	$ 1,514.5	$ 1,391.4

(1) Issued or borrowed by PRG
(2) Issued by Premcor USA
(3) Issued or borrowed by PAFC

The estimated fair value of long-term debt as of December 31, 2001 was $1,331.8 million (2000 $1,195.5 million), determined using quoted market prices for these issues.

In September 2001, PRG and Premcor USA repurchased in the open market $21.3 million in face value of its 9½% Senior Notes, $30.6 million in face value of its 10 7/8% Senior Notes, and $5.9 million in face value of its 11½% Exchangeable Preferred Stock (See Note 15 Exchangeable Preferred Stock) for an aggregate purchase price of $48.5 million. As a result of these transactions, the Company recorded a gain of $8.7 million, which included the write-off of deferred financing costs related to the debt issues.

The 8 5/8% Senior Notes were issued by PRG in August 1998, at a discount of 0.234% and are unsecured. The 8 5/8% Senior Notes are redeemable at the option of the Company beginning August 2003, at a redemption price of 104.312% of principal, which decreases to 100% of principal amount in 2005. Up to 35% in aggregate principal amount of the notes originally issued are redeemable at the option of the Company out of the net proceeds of one or more equity offerings at any time prior to August 15, 2002, at a redemption price equal to 108.625% of principal.

The 8 3/8% Senior Notes and 8 7/8% Senior Subordinated Notes were issued by PRG in November 1997, at a discount of 0.734% and 0.719%, respectively. These notes are unsecured, with the 8 7/8% Senior Subordinated Notes subordinated in right of payment to all unsubordinated indebtedness of PRG. The 8 3/8% Senior Notes and 8 7/8% Senior Subordinated Notes are redeemable at the option of PRG beginning November 2002, at a redemption price of 104.187% of principal and 104.437% of principal, respectively, which decreases to 100% of principal in 2004 and 2005, respectively.

PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

PRG borrowed $125.0 million in November 1997, and an additional $115.0 million in August 1998, under a floating rate term loan agreement expiring in 2004. In 2003, $31.3 million of the outstanding principal amount is due with the remainder of the outstanding principal due in 2004. The Floating Rate Loan is a senior unsecured obligation of the Company and bears interest at the London Interbank Offer Rate (LIBOR) plus a margin of 2.75%. The loan may be repaid subject to certain restrictive covenants as stated in the amended working capital facility agreement.

The 9½% Senior Notes were issued by PRG in September 1992 and are unsecured. The 9½% Senior Notes are currently redeemable at PRG s option at a redemption price of 100% of principal subject to certain restrictive covenants as stated in the secured revolving credit facility agreement. Under the indenture agreement for the 9½% Senior Notes, PRG is required to redeem $62.9 million of the 9½% Senior Notes on September 15, 2003 at 100% of principal.

In December 2001, PRG borrowed $10 million through the state of Ohio, which had issued Series 2001 Ohio bonds. PRG is the sole guarantor on the principal and interest payments of these bonds. PRG will bear a 2% interest rate for the first year commencing December 2001. Following the first year, PRG will be subject to a variable interest rate determined by the Trustee Bank not to exceed the maximum interest rate as defined under the indentures. PRG has the option of converting from a variable interest rate to a 30-year fixed interest rate. In the initial year, PRG has the option to redeem the bonds prior to maturity on or after May 1, 2002 through November 30, 2002 at a redemption price of 100% of principal plus accrued interest. Following the initial year, PRG has the option to redeem the bonds prior to maturity on or after April 1st of that year through November 30th of that year at a redemption price of 100% of principal plus accrued interest. If PRG decides to convert the bonds to a 30-year fixed interest rate, PRG has the option to redeem the bonds at a redemption price of 101%, declining to 100% the next year, of the principal plus accrued interest if the length of the fixed rate period is greater than 10 years. If the fixed rate period on the bonds is less than 10 years, there is no call provision.

The 10 $^{7}/8$% Senior Notes were issued by Premcor USA in December 1995 and are unsecured. These notes are currently redeemable at Premcor USA s option at a redemption price of 103.625% of principal, which decreases to 100% of principal in 2003.

PRG and Premcor USA note indentures contain certain restrictive covenants including limitations on the payment of dividends, limitations on the payment of amounts to related parties, limitations on the incurrence of debt, incurrence of liens and the maintenance of a minimum net worth. In order to make dividend payments PRG and Premcor USA must maintain a minimum net worth (as defined) of $150 million and $220 million, respectively, possess a cumulative earnings calculation (as defined) of greater than zero after a dividend payment is made, and not be in default of any covenants. In the event of a change of control of PRG, or Premcor USA, as defined in the indentures, the respective company is required to tender an offer to redeem its outstanding notes and floating rate term loans at 101% and 100% of face value, respectively, plus accrued interest.

The 12½% Senior Notes were issued by PAFC in August 1999 on behalf of PACC at par and are secured by substantially all of the assets of PACC. The 12½% Senior Notes are redeemable at the Company s option at any time at a redemption price equal to 100% of principal plus accrued and unpaid interest plus a make-whole premium which is based on the rates of treasury securities with average lives comparable to the average life of the remaining scheduled payments plus 0.75%.

In August 1999, PAFC entered into a Bank Senior Loan Agreement provided by commercial banks and institutional lenders. The Company had access to $325 million under the Bank Senior Loan Agreement, of which

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it drew $287.6 million as of December 31, 2001. The Bank Senior Loan Agreement is split into a Tranche A of $106.5 million with a term of 7½ years and a Tranche B of $181.1 million with a term of eight years. The interest rates on the bank senior loan agreement are based on LIBOR plus 4¾% for Tranche A and on LIBOR plus 5¼% for Tranche B. The ability to draw the unused portion of the loan expired in September 2001 when the heavy oil processing facility achieved substantial reliability. As required under the PAFC indentures, PACC entered into a transaction in April 2000 for $0.9 million that capped LIBOR at 7½% for a varying portion of the principal outstanding on their bank senior loan agreement. As of December 31, 2001, the cap had a market value of under $0.1 million. The cap is for a term from April 2000 through January 2004.

Under a common security agreement governing the PAFC debt, which contains common covenants, representations, defaults and other terms with respect to the 12½% Senior Notes, the bank senior loan agreement and the guarantees thereof by PACC, Sabine, and Neches, PACC is subject to restrictions on the making of distributions to Sabine and Neches. The common security agreement contains provisions that require the Company to maintain a secured account structure that reserves cash balances to be used for operations, capital expenditures, tax payments, major maintenance, interest, and debt repayments. This secured account structure must be funded and paid before PACC can make any restricted payments including dividends, except for $100,000 in distributions to Sabine and Neches each year to permit them to pay directors fees, accounting expenses, and other administrative expenses. In January 2002, PACC made a $59.7 million prepayment of its Bank Senior Loan Agreement pursuant to the common security agreement and secured account structure.

The common security agreement also requires that PACC carry insurance coverage with specified terms. However, due to the effects of the events of September 11, 2001 on the insurance market, coverage meeting such terms, particularly as it relates to deductibles, waiting periods and exclusions, was not available on commercially reasonable terms and, as a result, PACC s insurance program was not in full compliance with the required insurance coverage at December 31, 2001. However, the requisite parties to the common security agreement have waived the noncompliance provided that PACC obtain a reduced deductible limit for property damage by April 19, 2002, obtain additional contingent business interruption insurance by June 26, 2002 and continue to monitor the insurance market on a quarterly basis to determine if additional insurance coverage required by the common security agreement is available on commercially reasonable terms, and if so, promptly obtain such insurance. The Company believes that PACC will be able to comply with all of the conditions of the waiver.

The scheduled maturities of long-term debt during the next five years are (in millions): 2002 $81.4; 2003 $126.2; 2004 $343.6; 2005 $210.4; 2006 $54.4; 2007 and thereafter $658.2.

Interest and finance expense

Interest and finance expense included in the consolidated statements of operations, consisted of the following:

	For The Year Ended December 31,		
	1999	**2000**	**2001**
Interest expense	$ 108.3	$ 149.0	$ 147.7
Finance costs	18.0	12.7	16.0
Capitalized interest	(22.8)	(62.1)	(5.3)
Interest and finance expense	$ 103.5	$ 99.6	$ 158.4

Cash paid for interest expense in 2001 was $152.6 million (2000 $141.7 million; 1999 $93.5 million).

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11. Lease Commitments

The Company leases refinery equipment, catalyst, tank cars, office space, and office equipment from unrelated third parties with lease terms ranging from 1 to 8 years with the option to purchase some of the equipment at the end of the lease term at fair market value. The leases generally provide that the Company pay taxes, insurance, and maintenance expenses related to the leased assets. As of December 31, 2001, net future minimum lease payments under non-cancelable operating leases were as follows (in millions): 2002 $8.0, 2003 $7.4; 2004 $6.0, 2005 $5.7, 2006 $5.3, and $3.6 in the aggregate thereafter. Rental expense during 2001 was $9.1 million (2000 $9.9 million; 1999 $12.6 million).

12. Related Party Transactions

As of December 31, 2001, the Company had a payable to an affiliate of Blackstone of $0.3 million (December 31, 2000 $2.8 million). The Company has an agreement with this affiliate of Blackstone under which it receives a monitoring fee equal to $2.0 million per annum subject to increases relating to inflation and in respect to additional acquisitions by the Company. The Company recorded expenses related to the annual monitoring fee and the reimbursement of out-of-pocket costs of $2.0 million, $2.2 million and $2.5 million for the years ended December 31, 1999, 2000 and 2001, respectively. In 1999, the Company paid $8.0 million in advisory fees to an affiliate of Blackstone in connection with the structuring and construction of the heavy oil processing facility. Affiliates of Blackstone may in the future receive customary fees for advisory services rendered to the Company. Such fees will be negotiated from time to time with the independent members of the Company s board of directors on an arm s-length basis and will be based on the services performed and the prevailing fees then charged by third parties for comparable services.

13. Employee Benefit Plans

Postretirement Benefits Other Than Pensions

The Company provides health insurance in excess of social security and an employee paid deductible amount, and life insurance to most retirees once they have reached a specified age and specified years of service.

The following table sets forth the changes in the benefit obligation for the unfunded postretirement health and life insurance plans for 2000 and 2001:

	December 31,	
	2000	**2001**
Change in Benefit Obligation		
Benefit obligation at beginning of year	$ 39.6	$ 42.1
Service costs	1.3	1.3
Interest costs	2.9	3.4
Participants contribution		0.7
Plan amendments		0.7
Curtailment gain		(1.6)
Actuarial loss	0.1	17.9
Benefits paid	(1.8)	(2.8)
Benefit obligation at end of year	42.1	61.7
Unrecognized net gain (loss)	(0.1)	(17.7)
Unrecognized prior service benefit	0.2	(0.6)
Accrued postretirement benefit liability	$ 42.2	$ 43.4

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The components of net periodic postretirement benefit costs were as follows:

	For the Year Ended December 31,		
	1999	2000	2001
Service costs	$ 1.5	$ 1.3	$ 1.3
Interest costs	2.8	2.9	3.4
Amortization of prior service costs	(0.1)		
Net periodic postretirement benefit cost	$ 4.2	$ 4.2	$ 4.7

In measuring the expected postretirement benefit obligation, the Company assumed a discount rate of 7.25% (2000 7.75%), a rate of increase in the compensation level of 4.00% (2000 4.00%), and a health care cost trend ranging from 12.00% in 2002 declining to an ultimate rate of 5.00% in 2009. The effect of increasing the average health care cost trend rates by one percentage point would increase the accumulated postretirement benefit obligation as of December 31, 2001, by $8.4 million and increase the annual aggregate service and interest costs by $0.7 million. The effect of decreasing the average health care cost trend rates by one percentage point would decrease the accumulated postretirement benefit obligation, as of December 31, 2001, by $6.9 million and decrease the annual aggregate service and interest costs by $0.5 million.

Employee Savings Plan

The PRG Inc. Retirement Savings Plan and separate Trust (the Plan), a defined contribution plan, covers substantially all employees of the Company. Under the terms of the Plan, the Company matches the amount of employee contributions, subject to specified limits. Company contributions to the Plan during 2001 were $8.4 million (2000 $8.7 million; 1999 $8.4 million).

14. Income Taxes

The income tax provision (benefit) is summarized as follows:

	1999	2000	2001
Income (loss) from continuing operations before income taxes and minority interest	$ (82.4)	$ 64.5	$ 236.2
Income tax provision (benefit):			
Current provision (benefit) Federal	$ (17.9)	$ (0.9)	$ (0.2)
State	(2.3)	(0.7)	0.6
	(20.2)	(1.6)	0.4
Deferred provision (benefit) Federal	8.1	(24.2)	53.0
State	0.1		(1.0)
	8.2	(24.2)	52.0
Income tax provision (benefit)	$ (12.0)	$ (25.8)	$ 52.4

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A reconciliation between the income tax provision (benefit) computed on pretax income at the statutory federal rate and the actual provision (benefit) for income taxes is as follows:

	1999	2000	2001
Federal taxes computed at 35%	$ (28.9)	$ 22.6	$ 82.7
State taxes, net of federal effect	(0.2)	2.9	2.9
Valuation allowance	17.1	(50.8)	(30.0)
Other items, net		(0.5)	(3.2)
Income tax provision (benefit)	$ (12.0)	$ (25.8)	$ 52.4

The following represents the approximate tax effect of each significant temporary difference giving rise to deferred tax liabilities and assets:

	December 31,	
	2000	2001
Deferred tax liabilities:		
Property, plant and equipment	$ 112.4	$ 155.0
Turnaround costs	32.7	34.1
Inventory	5.7	4.3
Other	3.0	2.4
	153.8	195.8
Deferred tax assets:		
Alternative minimum tax credit	24.1	25.6
Environmental and other future costs	22.1	43.3
Tax loss carryforwards	146.3	96.5
Organizational and working capital costs	4.0	3.7
Other	11.1	10.0
	207.6	179.1
Valuation allowance	(30.0)	
Net deferred tax asset (liability)	$ 23.8	$ (16.7)

As of December 31, 2001, the Company has made net cumulative payments of $25.6 million under the federal alternative minimum tax system which are available to reduce future regular income tax payments. As of December 31, 2001, the Company had a federal net operating loss carryforward of $245.9 million and federal business tax credit carryforwards in the amount of $5.4 million. Such operating losses and tax credit carryforwards have carryover periods of 15 years (20 years for losses and credits originating in 1998 and years thereafter) and are available to reduce future tax liabilities through the year ending December 31, 2021. The tax credit carryover periods will begin to terminate with the year ending December 31, 2003 and the net operating loss carryover periods will begin to terminate with the year ending December 31, 2012.

The valuation allowance as of December 31, 2001 was nil (2000 $30.0 million). As of December 31, 2000, the Company provided a valuation allowance to reduce its deferred tax assets to amounts that were more likely than not to be realized. During the first quarter of 2001, the Company reversed its remaining deferred tax valuation allowance. In calculating the reversal of its remaining deferred tax valuation allowance, the Company assumed as future taxable income future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and available tax planning strategies. The reversal of the

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remaining deferred tax valuation allowance is primarily the result of the Company s analysis of the likelihood of realizing the future tax benefit of its federal and state tax loss carryforwards, alternative minimum tax credits and federal and state business tax credits.

During 2001, the Company made net federal cash payments of $11.9 million (2000 $3.5 million net cash refunds; 1999 $0.3 million net cash payments). Each member of the Premcor Inc. and Subsidiaries consolidated group provides for its portion of such consolidated refunds and liability under its tax sharing agreement with the other members of the consolidated group. During 2001, the Company made net state cash payments of $1.7 million (2000 $1.8 million net cash payments; 1999 $0.4 million net cash refunds).

The income tax provision of $52.4 million for 2001 reflected the effect of the decrease in the deferred tax valuation allowance of $30.0 million. The income tax benefit of $25.8 million for 2000 reflected the effect of the decrease in the deferred tax valuation allowance of $50.8 million. The income tax benefit of $12.0 million for 1999 reflected the effect of intraperiod tax allocations resulting from the utilization of current year operating losses to offset the net gain on the operations and sale of the discontinued retail division, offset by the write-down of a net deferred tax asset.

15. Exchangeable Preferred Stock of Subsidiary

In October 1997, Premcor USA converted a portion of its common stock to 63,000 shares ($1,000 liquidation preference per share) of 11½% Senior Cumulative Exchangeable Preferred Stock. The Exchangeable Preferred Stock is redeemable at Premcor USA s option, in whole or part, on or after October 1, 2002 at the redemption price of 105.75% of principal. Premcor USA is required, subject to certain conditions, to redeem all of the Exchangeable Preferred Stock on October 1, 2009. The Exchangeable Preferred Stock is exchangeable, subject to certain conditions, at the option of Premcor USA into 11½% Subordinated Debentures due 2009. As of December 31, 2001, all dividends had been paid by issuing additional shares of exchangeable preferred stock except $0.3 million paid in cash in September 2001 as it related to the repurchase of a portion of the exchangeable preferred stock. In March 2002, the Company gave notice of the intention to exchange the 11½% Exchangeable Preferred Stock for 11½% Subordinated Debentures due October 2009.

16. Stockholders Equity

Premcor Inc. has outstanding Common Stock and Class F Common Stock. The Class F Common Stock has voting rights limited to 19.9% of the total voting power of all of Premcor Inc. s voting stock and is currently held solely by Occidental. The Class F Common Stock is convertible into Common Stock by any stockholder of this class other than Occidental. All other non-voting rights including dividend, liquidation, and dissolution are determined on a share-for-share basis.

In August 1999, Blackstone and Occidental signed capital contribution agreements related to the financing of the heavy oil upgrade project totaling $135.0 million. Blackstone agreed to contribute $121.5 million, and Occidental agreed to contribute $13.5 million. Funding of the capital contributions occurred on a pro-rata basis as proceeds were received from borrowings under the bank senior loan agreement. In the third quarter of 2001, the Company decided not to borrow the remaining loan commitment under the bank senior loan agreement and consequently forfeited the remaining $13.2 million outstanding capital contributions. The ability to draw any remaining funds under the bank senior loan agreement and receive the remaining capital contributions expired in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

September of 2001 upon the achievement of substantial reliability of the heavy oil upgrade project. As of December 31, 2001, Blackstone and Occidental contributed $109.6 million and $12.2 million, respectively, of their commitments. Occidental s contributions under the capital contribution agreement were made directly to Sabine.

In 1999, in addition to the contributions related to the capital contribution agreement, Blackstone contributed $8.1 million to enable the purchase of the equity interest in CRE and to enable the payment of certain fees owed by the Company. All Blackstone shares were Common Stock issued at $9.90 per share. In 1999, Premcor Inc. also issued 65,656 shares of Common Stock to a member of its board of directors for $0.6 million for services rendered to the Company. In 1999, Premcor USA settled a lawsuit with its previous minority interest holder for $3.6 million, which was recorded as a reduction in paid-in capital.

In August 1999, Premcor Inc. issued warrants to Blackstone to purchase 2,430,000 shares of Common Stock at a price of $0.01 per share. The warrants may be exercised at any time in whole or part. Sabine issued warrants to Occidental to purchase 30,000 shares of Sabine s common stock at a price of $0.09 per share. The warrants, which do not expire, may be exercised at any time in whole or part. Upon exercise of these warrants, Occidental has the option to exchange each warrant share for nine shares of Premcor Inc. s Class F Common Stock. None of the warrants were exercised as of December 31, 2001.

17. Stock Option Plans

In 1999, the Premcor USA Long-Term Performance Plan was replaced with the Premcor Inc. Stock Incentive Plan (Incentive Plan). Under the Incentive Plan, employees of PRG and its subsidiaries are eligible to receive awards of options to purchase shares of the common stock of Premcor Inc. The Incentive Plan is intended to attract and retain executives and other selected employees whose skills and talents are important to the operations of Premcor Inc. and its subsidiaries. Options on an aggregate amount of 2,215,250 shares of Premcor Inc. s common stock may be awarded under the Incentive Plan, either from authorized, unissued shares which have been reserved for such purpose or from authorized, issued shares acquired by or on behalf of the Company. The current aggregate amount of stock available to be awarded is subject to a stock dividend or split, reorganization, recapitalization, merger, consolidation, spin-off, combination or exchange of stock.

Summarized below is the status of the Incentive Plan as of December 31, 1999, 2000 and 2001:

	1999		2000		2001	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Options outstanding, beginning of period		$	1,905,000	$ 10.31	1,782,300	$ 10.25
Granted	1,905,000	10.31	207,300	9.90	200,000	9.90
Forfeited			(330,000)	10.36	(176,250)	9.90
Options outstanding, end of period	1,905,000	10.31	1,782,300	10.25	1,806,050	10.25
Exercisable at end of period	482,125	11.51	458,500	11.26	560,500	11.01
Weighted average fair value of options granted	$ 4.10		$ 3.65		$ 3.10	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Summarized below is information about the stock options outstanding under the Incentive Plan as of December 31, 2001:

Exercise Price	Options Outstanding at 12/31/01	Options Exercisable at 12/31/01	Remaining Contractual Life
$9.90	1,683,550	438,000	81 months
$15.00	122,500	122,500	38 months
$9.90 $15.00	1,806,050	560,500	

The fair value of these options was estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

	1999	2000	2001
Assumed risk-free rate	5.92%	5.82%	4.95%
Expected life	8.7 years	7.9 years	7.6 years

For these respective years, the expected dividends were assumed to be zero and the expected volatility was assumed to be 1% since the stock underlying the options is not publicly traded.

Pursuant to SFAS No. 123 *Accounting for Stock Based Compensation*, the Company has elected to account for its stock option plan under APB Opinion No. 25 *Accounting for Stock Issued to Employees* and adopt the disclosure only provisions of SFAS No. 123. Under APB Opinion No. 25, no compensation costs are recognized because the option exercise price is equal to the fair market price of the common stock on the date of the grant. Under SFAS No. 123, stock options are valued at grant date using the Black Scholes valuation model and compensation costs are recognized ratably over the vesting period. Had compensation costs been determined as prescribed by SFAS No. 123, the Company s net earnings would have been impacted by less than $1.0 million for each of the years ended December 31, 1999, 2000, and 2001.

Options granted under the plan are either time vesting or performance vesting options. The time vesting options vest in one of the following three manners: (i) 50% at date of grant and 25% on each January 1 thereafter, (ii) 1/3 on the first, second and third anniversaries of the date of grant, or (iii) 1/4 on the first, second, third and fourth anniversaries of the date of grant. The performance vesting options fully vest on and after the seventh anniversary of the date of option; provided, however, that following a public offering of the common stock or upon a change in control, the vesting is accelerated based on the achievement of certain share prices of the common stock. The accelerated vesting schedule is as follows:

AVERAGE CLOSING PRICE PER SHARE OF CAPITAL STOCK FOR ANY 180 CONSECUTIVE DAYS; OR CHANGE IN CONTROL PRICE	% OF SHARES WITH RESPECT TO WHICH OPTION IS EXERCISABLE
Below $12.00	0%
$12.00 $14.99	10%
$15.00 $17.99	20%
$18.00 $19.99	30%
$20.00 $24.99	50%
$25.00 $29.99	75%
Above $29.99	100%

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The change in control price is defined as the highest price per share received by any holder of the common stock from the purchaser(s) in a transaction or series of transactions that result in a change in control. All options expire no more than ten years after the date of grant.

In the event of a change of control of PRG, the Board with respect to any award may take such actions that result in (i) the acceleration of the award, (ii) the payment of a cash amount in exchange for the cancellation of an award and/or (iii) the requiring of the issuance of substitute awards that will substantially preserve the value, rights, and benefits of any affected awards.

18. Commitments and Contingencies

Legal and Environmental

As a result of its activities, the Company is the subject of a number of legal and administrative proceedings, including proceedings related to environmental matters. All such matters that could be material or to which a governmental authority is a party and which involve potential monetary sanctions of $100,000 or greater are described below.

Port Arthur: Enforcement. The Texas Commission on Environmental Quality (TCEQ) conducted a site inspection of the Port Arthur refinery in the spring of 1998. In August 1998, the Company received a notice of enforcement alleging 47 air-related violations and 13 hazardous waste-related violations. The number of allegations was significantly reduced in an enforcement determination response from TCEQ in April 1999. A follow-up inspection of the refinery in June 1999 concluded that only two items remained outstanding, namely that the refinery failed to maintain the temperature required by the air permit at one of its incinerators and that five process wastewater sump vents did not meet applicable air emission control requirements. The TCEQ also conducted a complete refinery inspection in the second quarter of 1999, resulting in another notice of enforcement in August 1999. This notice alleged nine air-related violations, relating primarily to deficiencies in the Company s upset reports and emissions monitoring program, and one hazardous waste-related violation concerning spills. The 1998 and 1999 notices were combined and referred to the TCEQ s litigation division. On September 7, 2000 the TCEQ issued a notice of enforcement regarding the Company s alleged failure to maintain emission rates at permitted levels. In May 2001, the TCEQ proposed an order covering some of the 1998 hazardous waste allegations, the incinerator temperature deficiency, the process wastewater sumps, and all of the 1999 and 2000 allegations, and proposing the payment of a fine of $562,675 and the implementation of a series of technical provisions requiring corrective actions. Negotiations with the TCEQ are ongoing.

Lima: Finding of Violation. On July 10, 2001, the Ohio Environmental Protection Agency issued a finding of violation by the Company of state and federal laws regarding releases of annual benzene quantities into wastewater streams in excess of that allowed and downtime for the Company s continuous emission control monitors that exceeded the allowed 5%. The Company has settled this action, paid a fine of $120,000 and implemented preventative programs to ensure future compliance.

Hartford: Federal Enforcement. In February 1999, the federal government filed a complaint in the matter, *United States v. Clark Refining & Marketing, Inc.*, alleging violations of the Clean Air Act and regulations promulgated thereunder, in the operation and permitting of the Hartford refinery fluid catalytic cracking unit. The Company settled this action in July 2001 by agreeing to install a wet gas scrubber on the fluid catalytic cracking unit and low nitrogen oxide burners, and agreeing to pay a civil penalty of $2 million. As a result of the planned closure of the Hartford refinery in September 2002, we do not anticipate making these capital expenditures.

Blue Island: Federal and State Enforcement. In September 1998, the federal government filed a complaint, *United States v. Clark Refining & Marketing, Inc.*, alleging that the Blue Island refinery violated federal environmental laws relating to air, water and solid waste. The Illinois Attorney General intervened in the

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

case. The State of Illinois and Cook County had also brought an action, several years earlier, *People ex rel. Ryan v. Clark Refining & Marketing, Inc.*, also alleging violations under environmental laws. In the first quarter of 2002, PRG reached an agreement to settle both cases, subject to final approval by the state and federal courts. The consent order in the federal case requires the payment of $6.25 million as a civil penalty and requires limited ongoing monitoring at the now-idled refinery. The consent order in the state case requires an ongoing tank inspection program along with enhanced reporting obligations and requires that the parties enter a process to complete an appropriate site remediation program at the Blue Island refinery. The consent orders dispose of both the federal and state cases. It is anticipated that both the state and federal courts will approve the proposed settlement early in the second quarter of 2002.

Blue Island: Criminal Matters. In June 2000, PRG pled guilty to one felony count of violating the Clean Water Act and one count of conspiracy to defraud the United States at the Blue Island refinery. These charges arose out of the discovery, during an Environmental Protection Agency (EPA) investigation at the site conducted in 1996, that two former employees had allegedly falsified certain reports regarding wastewater sent to the municipal wastewater treatment facility. As part of the plea agreement, PRG agreed to pay a fine of $2 million and was placed on probation for three years beginning September 22, 2000. The Company does not anticipate that the probation of PRG will have a significant adverse impact on its business on an ongoing basis. The primary remaining condition of probation is an obligation not to commit future environmental crimes. If PRG were to commit a crime in the future, it would be subject not only to prosecution for that new violation, but also to a separate charge that it had violated a condition of its probation. Any violation of probation charge would be brought before the same judge who entered the original sentence, and that judge would have the authority to enter a new and potentially more severe sentence for the offense to which PRG pled guilty in June 2000. One of the former employees pled guilty to a misdemeanor charge and was placed on one-year probation and the other former employee was found guilty on felony charges and sentenced to 21 months in prison related to these events.

Blue Island: Class Action Matters. In October 1994, the Company s Blue Island refinery experienced an accidental release of used catalyst into the air. In October 1995, a class action, *Rosolowski v. Clark Refining & Marketing, Inc., et al.*, was filed against the Company seeking to recover damages in an unspecified amount for alleged property damage and personal injury resulting from that catalyst release. The complaint underlying this action was later amended to add allegations of subsequent events that allegedly diminished property values. In June 2000, the Company s Blue Island refinery experienced an electrical malfunction that resulted in another accidental release of used catalyst into the air. Following the 2000 catalyst release, two cases were filed purporting to be class actions, *Madrigal et al. v. The Premcor Refining Group Inc.* and *Mason et al. v. The Premcor Refining Group Inc*. Both cases seek damages in an unspecified amount for alleged property damage and personal injury resulting from that catalyst release. These cases have been consolidated for the purpose of conducting discovery, which is currently proceeding.

Sashabaw Road Retail Location: State Enforcement. In July 1994, the Michigan Department of Natural Resources brought an action alleging that one of the Company s retail locations caused groundwater contamination, necessitating the installation of a new $600,000 drinking water system. The Michigan Department of Natural Resources sought reimbursement of this cost. Although this site may have contributed to contamination in the area, the Company maintained that numerous other sources were responsible and that a total reimbursement demand from the Company would be excessive. Mediation resulted in a $200,000 finding against the Company. The Company made an offer of judgment equal to the mediation finding. The offer was rejected by the Michigan Department of Natural Resources and the matter was tried in November 1999, resulting in a judgment against the Company of $110,000 plus interest. Since the judgment was over 20% below the previous settlement offer, under applicable state law the Company is entitled to recover its legal fees. Both the Michigan Department of Natural Resources and the Company have appealed the decision.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

New Source Review Permit Issues. New Source Review requirements under the Clean Air Act apply to newly constructed facilities, significant expansions of existing facilities, and significant process modifications and requires new major stationary sources and major modifications at existing major stationary sources to obtain permits, perform air quality analysis and install stringent air pollution control equipment at affected facilities. The EPA has commenced an industry-wide enforcement initiative regarding New Source Review. The current EPA initiative, which includes sending numerous refineries information requests pursuant to Section 114 of the Clean Air Act, appears to target many items that the industry has historically considered routine repair, replacement, maintenance or other activity exempted from the New Source Review requirements.

The Company has responded to an information request from the EPA regarding New Source Review compliance at its Port Arthur and Lima refineries, both of which were purchased within the last seven years. The Company believes that any costs to respond to New Source Review issues at those refineries prior to our purchase are the responsibility of the prior owners and operators of those facilities. The Company responded to the request in late 2000, providing information relating to the Company s period of ownership, and the Company is awaiting a response.

In July 2001, the Company settled a lawsuit with the EPA and the State of Illinois that resolved, among other historic compliance issues, a New Source Review issue resulting from repairs made to the fluid catalytic cracking unit at the Hartford refinery in 1994.

The federal and state enforcement action at the Blue Island refinery, which has been settled with the EPA and the State of Illinois also included New Source Review issues. The Company believes that a resolution of the Blue Island litigation will include a resolution of these issues and that the EPA s Section 114 request will not be material to the Company s financial condition or results of operations.

Port Arthur: Natural Resource Damage Assessment. In 1999, Premcor USA Inc. and Chevron were notified by a number of federal and Texas agencies that a study would be conducted to determine whether any natural resource damage occurred as a result of the operation of the Port Arthur refinery prior to January 1, 2000. The Company is cooperating with the government agencies in this investigation. The Company has entered into an agreement with Chevron pursuant to which Chevron will indemnify the Company for any future claims in consideration of a payment of $750,000, which we paid in October 2001.

Port Arthur and Lima Refineries. The original refineries on the sites of the Port Arthur and Lima refineries began operating in the late 1800s and early 1900s, prior to modern environmental laws and methods of operation. There is contamination at these sites, which the Company believes will be required to be remediated. Under the terms of the Company s 1995 purchase of the Port Arthur refinery, Chevron Products Company, the former owner, retained liability for all required investigation and remediation relating to pre-purchase contamination discovered by June 1997, except with respect to certain areas on or around which active processing units are located, which are the Company s responsibility. Less than 200 acres of the 4,000-acre refinery site are occupied by active operating units. Extensive due diligence efforts prior to the acquisition and additional investigation after the acquisition documented contamination for which Chevron is responsible. In June 1997, the Company entered into an agreed order with Chevron and the TCEQ, that incorporates this contractual division of the remediation responsibilities into an agreed order. The Company has accrued $11.4 million (December 31, 2000 $8.6 million) for the Port Arthur remediation as of December 31, 2001. Under the terms of the purchase of the Lima refinery, BP PLC (BP), the former owner, indemnified the Company for all pre-existing environmental liabilities, except for contamination resulting from releases of hazardous substances in or on sewers, process units and other equipment at the refinery as of the closing date, but only to the extent the presence of these hazardous substances was as a result of normal operations of the refinery and does not constitute a violation of any environmental law. Although the Company is not primarily responsible for the

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

majority of the currently required remediation of these sites, the Company may become jointly and severally liable for the cost of investigating and remediating a portion of these sites in the event that Chevron or BP fails to perform the remediation. In such event, however, the Company believes it would have a contractual right of recovery from these entities. The cost of any such remediation could be substantial and could have a material adverse effect on the Company s financial position.

Blue Island Refinery Decommissioning and Closure. In January 2001, the Company ceased operations at its Blue Island, Illinois refinery although the Company continues to operate the adjacent Alsip terminal. The decommissioning, dismantling and tear down of the facility is underway. The Company is currently in discussions with federal, state and local governmental agencies concerning remediation of the site. The governmental agencies have proposed a remediation process patterned after national contingency plan provisions of the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA). The Company has proposed to the agencies a site investigation and remediation that incorporates certain elements of the CERCLA process and the State of Illinois site remediation program. Related to the closure of the facility, we accrued $56.4 million for decommissioning, remediation of the site and asbestos abatement. As of December 31, 2001, the Company had spent $22.0 million. In the second quarter of 2002, the Company expects to finalize procurement of environmental risk insurance policies. This program will allow the Company to better estimate and, within the limits of the policy, cap the Company s cost to remediate the site, and provide insurance coverage from future third party claims arising from past or future environmental releases. The remediation cost overrun policy has a term of ten years and, subject to certain exceptions and exclusions, provides $25 million in coverage in excess of a self insured retention amount of $26 million. The pollution legal liability policy provides for $25 million in aggregate coverage and per incident coverage in excess of a self insured retention of $250,000 per incident. The Company believes this insurance program also provides the governmental agencies financial assurance that, once begun, remediation of the site will be completed in a timely and prudent manner.

Former Retail Sites. In 1999, the Company sold its former retail marketing business, which the Company operated from time to time on a total of 1,150 sites. During the normal course of operations of these sites, releases of petroleum products from underground storage tanks have occurred. Federal and state laws require that contamination caused by such releases at these sites be assessed and remediated to meet applicable standards. The enforcement of the underground storage tank regulations under the Resource Conservation and Recovery Act has been delegated to the states that administer their own underground storage tank programs. The Company s obligation to remediate such contamination varies, depending upon the extent of the releases and the stringency of the laws and regulations of the states in which the releases were made. A portion of these remediation costs may be recoverable from the appropriate state underground storage tank reimbursement fund once the applicable deductible has been satisfied. The 1999 sale included 672 sites, 225 of which had no known pre-closure contamination, 365 of which had known pre-closure contamination of varying extent, and 80 of which had been previously remediated. The purchaser of the retail division assumed pre-closure environmental liabilities of up to $50,000 per site at the sites on which there was no known contamination. The Company is responsible for any liability above that amount per site for pre-closure liabilities, subject to certain time limitations. With respect to the sites on which there was known pre-closing contamination, the Company retained liability for 50% of the first $5 million in remediation costs and 100% of remediation costs over that amount. The Company retained any remaining pre-closing liability for sites that had been previously remediated.

Of the remaining 478 former retail sites not sold in the 1999 transaction described above, the Company has sold all but 11 in open market sales and auction sales. The Company generally retains the remediation obligations for sites sold in open market sales with identified contamination. Of the retail sites sold in auctions, the Company agreed to retain liability for all of these sites until an appropriate state regulatory agency issues a letter indicating that no further remedial action is necessary. However, these letters are subject to revocation if it is later determined that contamination exists at the properties and the Company would remain liable for the remediation

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of any property at which such a letter was received but subsequently revoked. The Company is currently involved in the active remediation of 139 of the retail sites sold in open market and auction sales and is actively seeking to sell the remaining 11 properties. During the period from the beginning of 1999 through 2001, the Company had expended $17 million to satisfy the obligations described above and as of December 31, 2001, had $26.6 million (December 31, 2000 $6.1 million) accrued, net of reimbursements of $12.2 million (December 31, 2000 $3.1 million), to satisfy those obligations in the future.

Former Terminals. In December 1999, the Company sold 15 refined product terminals to a third party, but retained liability for environmental matters at four terminals and, with respect to the remaining eleven terminals, the first $250,000 per year of environmental liabilities for a period of six years up to a maximum of $1.5 million. As of December 31, 2001, the Company had expended $0.5 million on these obligations and has accrued $2.9 million (December 31, 2000 $3.1 million) for these obligations in the future including additional investigative and administrative costs.

Legal and Environmental Reserves. As a result of its normal course of business, the Company is a party to a number of legal and environmental proceedings. As of December 31, 2001, the Company had accrued a total of approximately $77 million (December 31, 2000 $34 million), on an undiscounted basis, for legal and environmental-related obligations that may result from the matters noted above and other legal and environmental matters. The Company is of the opinion that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company. However, an adverse outcome of any one or more of these matters could have a material effect on quarterly or annual operating results or cash flows when resolved in a future period.

Environmental Product Standards

Reformulated Fuels. EPA regulations also require that reformulated gasoline and low sulfur diesel intended for all on-road consumers be produced for ozone non-attainment areas, including Chicago, Milwaukee and Houston, which are in the Company s direct market areas. In addition, because St. Louis is a voluntary participant in the EPA s ozone reduction program, reformulated gasoline and low sulfur diesel is also required in the St. Louis market area, another of the Company s direct market areas. Expenditures necessary to comply with existing reformulated fuels regulations are primarily discretionary. The Company s decision of whether or not to make these expenditures is driven by market conditions and economic factors. The reformulated fuels programs impose restrictions on properties of fuels to be refined and marketed, including those pertaining to gasoline volatility, oxygenate content, detergent addition and sulfur content. The restrictions on fuel properties vary in markets in which the Company operates, depending on attainment of air quality standards and the time of year. The Port Arthur and Hartford refineries can produce up to approximately 60% and 25%, respectively, of gasoline production in reformulated gasoline. Each refinery s maximum reformulated gasoline production may be limited by the clean fuels attainment of the Company s total refining system. The Port Arthur refinery s diesel production complies with the current on-road sulfur specification of 500 parts per million, or ppm.

Tier 2 Motor Vehicle Emission Standards. In February 2000, the EPA promulgated the Tier 2 Motor Vehicle Emission Standards Final Rule for all passenger vehicles, establishing standards for sulfur content in gasoline. These regulations mandate that the sulfur content of gasoline at any refinery not exceed 30 ppm during any calendar year by January 1, 2006. These requirements will be phased in beginning on January 1, 2004. It is the Company s intent to meet these specifications from the Port Arthur and Lima refineries on a timely basis. However, the Company has concluded that there is no economically viable manner of reconfiguring the Hartford refinery to produce fuels which meet these new specifications and the new diesel fuel specifications discussed below. Modifications will be required at the Port Arthur and Lima refineries as a result of the Tier 2 standards.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company believes, based on current estimates, that compliance with the new Tier 2 gasoline specifications will require capital expenditures in the aggregate through 2005 of approximately $176 million at those refineries. The Company s current estimate represents a decrease from our preliminary estimates due to the decision to close the Hartford refinery. More than 95% of the total investment to meet the Tier 2 gasoline specifications is expected to be incurred during 2002 through 2004 with the greatest concentration of spending occurring in 2003.

Low Sulfur Diesel Standards. In January 2001, the EPA promulgated its on-road diesel regulations, which will require a 97% reduction in the sulfur content of diesel fuel sold for highway use by June 1, 2006, with full compliance by January 1, 2010. Refining industry groups have filed two lawsuits, which may delay implementation of the on-road diesel rule beyond 2006. The EPA has estimated that the overall cost to fuel producers of the reduction in sulfur content would be approximately $0.04 per gallon. The EPA has also announced its intention to review the sulfur content in diesel fuel sold to off-road consumers. If regulations are promulgated to regulate the sulfur content of off-road diesel, the Company expects the sulfur requirement to be either 500 ppm, which is the current on-road limit, or 15 ppm, which will be the future on-road limit. It is the Company s intent to meet these specifications from the Port Arthur and Lima refineries on a timely basis. However, the Company has concluded that there is no economically viable manner of reconfiguring our Hartford refinery to produce fuels which meet these new specifications and the new gasoline fuel specifications discussed above. The Company estimates capital expenditures in the aggregate through 2006 required to comply with the diesel standards at our Port Arthur and Lima refineries, utilizing existing technologies, is approximately $225 million. More than 90% of the projected investment is expected to be incurred during 2004 through 2006 with the greatest concentration of spending occurring in 2005. The Company has initiated a project at the Port Arthur refinery to comply with these new diesel fuel specifications in conjunction with an expansion of this refinery to 300,000 bpd. The Company is also evaluating potential projects to reconfigure our Lima refinery to process a more sour and heavier crude slate. The Company believes these projects, combined with the low sulfur gasoline and diesel fuel investments, will offer a reasonable return on capital.

Maximum Available Control Technology. In September 1998, the EPA proposed regulations to implement Phase II of the petroleum refinery Maximum Achievable Control Technology rule under the federal Clean Air Act, referred to as MACT II, which regulates emissions of hazardous air pollutants from certain refinery units. Finalization of the MACT II regulations has been delayed in an attempt to harmonize the MACT II requirements with Tier 2 gasoline and low sulfur diesel requirements. If the MACT II regulations are finalized and implemented as proposed, in order to comply, the Company expects to spend approximately $45 million in the three years following their finalization with the greatest concentration of spending likely in 2003 and 2004.

Other Commitments

Crude Oil Purchase Commitment. In 1999, the Company sold crude oil linefill in the pipeline system supplying the Lima refinery. An agreement is in place that requires the Company to repurchase approximately 2.7 million barrels of crude oil in this pipeline system on September 30, 2002 at the then current market prices. The Company has hedged the price risk related to the repurchase obligations through the purchase of exchange-traded futures contracts.

Long-Term Crude Oil Contract

PACC is party to a long-term crude oil supply agreement with PEMEX which supplies approximately 160,000 barrels per day of Maya crude oil. The long-term crude oil supply agreement includes a price adjustment mechanism designed to minimize the effect of adverse refining margin cycles and to moderate the fluctuations of the coker gross margin, a benchmark measure of the value of coker production over the cost of coker feedstock.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

This price adjustment mechanism contains a formula that represents an approximation for the coker gross margin and provides for a minimum average coker gross margin of $15 per barrel over the first eight years of the agreement, which began on April 1, 2001. The agreement expires in 2011.

On a monthly basis, the actual coker gross margin is calculated and compared to the minimum. Coker gross margins exceeding the minimum are considered a surplus while coker gross margins that fall short of the minimum are considered a shortfall. On a quarterly basis, the surplus and shortfall determinations since the beginning of the contract are aggregated. Pricing adjustments to the crude oil the Company purchases are only made when there exists a cumulative shortfall. When this quarterly aggregation first reveals that a cumulative shortfall exists, the Company receives a discount on crude oil purchases in the next quarter in the amount of the cumulative shortfall. If thereafter, the cumulative shortfall incrementally increases, the Company receives additional discounts on crude oil purchases in the succeeding quarter equal to the incremental increase, and conversely, if thereafter, the cumulative shortfall incrementally decreases, the Company repays discounts previously received, or a premium, on crude oil purchases in the succeeding quarter equal to the incremental decrease. Cash crude oil discounts received by the Company in any one quarter are limited to $30 million, while the Company s repayment of previous crude oil discounts, or premiums, are limited to $20 million in any one quarter. Any amounts subject to the quarterly payment limitations are carried forward and applied in subsequent quarters.

As of December 31, 2001, as a result of the favorable market conditions related to the value of Maya crude oil versus the refined products derived from it, a cumulative quarterly surplus of $110.0 million existed under the contract. As a result, to the extent the Company experiences quarterly shortfalls in coker gross margins going forward, the price the Company pays for Maya crude oil in succeeding quarters will not be discounted until this cumulative surplus is offset by future shortfalls.

19. Subsequent Events

In February 2002, the Company hired Thomas D. O Malley as chairman, chief executive officer, and president and William E. Hantke as executive vice president and chief financial officer. Accordingly, in 2002 the Company will recognize severance expenses related to the resignation of the officers who previously held these positions. Also in conjunction with this management change, two new stock incentive plans were approved by the Board of Directors.

The 2002 Special Stock Incentive Plan was adopted in connection with the employment of Thomas D. O Malley and allows for the issuance of stock options of Premcor Inc. s common stock. Under this plan, 3,400,000 shares of Premcor Inc. s common stock may be awarded for stock options granted. As of March 2002, 2,200,000 stock options had been granted at an exercise price of $10 per share. The 2002 Equity Incentive Plan was adopted to award key employees, directors, and consultants with various stock options, stock appreciation rights, restricted stock, performance-based awards and other common stock based awards of Premcor Inc. s common stock. Under the 2002 Equity Incentive Plan, 1,500,000 shares of Premcor Inc. s common stock may be awarded for stock options granted under this plan, of which 350,000 stock options were granted at an exercise price of $10 per share as of March 2002.

The Company approved a plan to discontinue refining operations at the Hartford refinery in October 2002. Although the Hartford refinery has contributed to the Company s earnings in the past, the Company has concluded that there is no economically viable manner of reconfiguring the refinery to produce fuels which meet new gasoline and diesel fuel standards mandated by the federal government. The Company plans to record a pretax charge to earnings of approximately $120 million in the first quarter of 2002 which includes a $65 million non-cash asset write-down and $55 million related primarily to accruals for employee severance, other shutdown costs and future environmental expenses. The actual cash payment of these future expenses would occur over several years following the shutdown.

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INDEPENDENT AUDITORS REPORT

To the Board of Directors of Premcor Inc.:

We have audited the consolidated financial statements of Premcor Inc. as of December 31, 2000 and 2001, and for each of the three years in the period ended December 31, 2001 and have issued our report thereon dated February 11, 2002 (included elsewhere in this Registration Statement). Our audits also included the financial statement schedule listed in Item 16(b) of this Registration Statement. This financial statement schedule is the responsibility of the Company s management. Our responsibility is to express an opinion based on our audits. In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP

St. Louis, Missouri
February 11, 2002

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PREMCOR INC.

SCHEDULE I CONDENSED INFORMATION OF THE REGISTRANT
PARENT COMPANY ONLY BALANCE SHEETS
(dollars in millions except share data)

	December 31, 2000	December 31, 2001
ASSETS		
CURRENT ASSETS:		
Cash	$	$ 2.1
Receivables from affiliates	16.4	28.4
Income taxes receivable		13.7
Total current assets	16.4	44.2
INVESTMENTS IN AFFILIATED COMPANIES	332.3	475.4
	$ 348.7	$ 519.6
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Payable to affiliates	$ 11.2	$ 40.8
Income taxes payable	1.3	
Total current liabilities	12.5	40.8
COMMON STOCKHOLDERS EQUITY:		
Common, $0.01 par value per share, 53,000,000 authorized, 25,720,589 issued and outstanding in 2000 and 2001; Class F Common, $0.01 par value per share, 7,000,000 authorized, 6,101,010 issued and outstanding in 2000 and 2001	0.3	0.3
Paid-in capital	327.2	327.2
Retained earnings	8.7	151.3
Total common stockholders equity	336.2	478.8
	$ 348.7	$ 519.6

See accompanying note to non-consolidated financial statements.

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PREMCOR INC.

SCHEDULE I CONDENSED INFORMATION OF THE REGISTRANT
PARENT COMPANY ONLY STATEMENTS OF OPERATIONS
(dollars in millions)

	For the Period From April 27, 1999 (Inception) to December 31, 1999	For the Year Ended December 31, 2000	For the Year Ended December 31, 2001
REVENUES:			
Equity in net income (loss) of affiliates	$ (71.4)	$ 80.2	$ 142.9
EXPENSES:			
General and administrative expenses		0.1	0.2
Interest expense			0.2
INCOME (LOSS) BEFORE INCOME TAXES	(71.4)	80.1	142.5
Income tax benefit			0.1
NET INCOME (LOSS)	$ (71.4)	$ 80.1	$ 142.6

See accompanying note to non-consolidated financial statements.

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PREMCOR INC.

**SCHEDULE I CONDENSED INFORMATION OF THE REGISTRANT
PARENT COMPANY ONLY STATEMENTS OF CASH FLOWS
(dollars in millions)**

	For the Period From April 27, 1999 (Inception) to December 31, 1999	For the Year Ended December 31, 2000	For the Year Ended December 31, 2001
Cash flows from operating activities:			
Net income (loss)	$ (71.4)	$ 80.2	$ 142.6
Adjustments:			
Equity in net income (loss) of affiliates	71.4	(80.2)	(142.9)
Other		0.8	(0.2)
Cash provided by (reinvested in) working capital			
Receivables from and payables to affiliates	(3.9)	(1.3)	17.6
Income taxes payable		1.3	(15.0)
Net cash provided by (used in) operating activities	(3.9)	0.8	2.1
CASH FLOWS FROM INVESTING ACTIVITIES:			
Investment in affiliates	(56.4)	(58.1)	
Net cash used in investing activities	(56.4)	(58.1)	
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of common stock	60.3	57.3	
Net cash provided by financing activities	60.3	57.3	
NET INCREASE IN CASH AND CASH EQUIVALENTS			2.1
CASH AND CASH EQUIVALENTS, beginning of period			
CASH AND CASH EQUIVALENTS, end of period	$	$	$ 2.1

See accompanying note to non-consolidated financial statements.

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PREMCOR INC.

SCHEDULE I CONDENSED INFORMATION OF THE REGISTRANT NOTE TO NON-CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD FROM APRIL 27, 1999 (INCEPTION) TO DECEMBER 31, 1999 AND THE YEARS ENDED DECEMBER 31, 2000 AND 2001

1. Basis of Presentation

Premcor Inc. was formed pursuant to an April 27, 1999 Share Exchange Agreement wherein all shares of Premcor USA Inc. were exchanged on a one-for-one basis for shares of Premcor Inc. The accompanying financial statement schedule has been prepared for the period beginning from the inception of Premcor Inc.

These non-consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America, except that they are prepared on a non-consolidated basis for the purpose of complying with Article 12 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. Premcor Inc. s non-consolidated operations include 100% equity interest in Premcor USA Inc., 90% interest in Sabine Holding Corp., and a 5% interest in Clark Retail Enterprises.

For further information, refer to the consolidated financial statements, including the notes thereto, included in this Registration Statement.

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PREMCOR INC.

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS
(dollars in millions)

	Balance at beginning of year	Charged to expense	Net cash outlays	Balance at end of year
Asset Reserve:				
Accounts Receivable	$ 1.3	$	$	$ 1.3
Liability Reserve:				
Blue Island refinery closure reserve	$	$ 69.1	$ (32.6)	$ 36.5

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INDEPENDENT ACCOUNTANTS REPORT

To the Board of Directors of Premcor Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Premcor Inc. and its subsidiaries (the Company) as of September 30, 2002, the related condensed consolidated statements of operations for the nine months ended September 30, 2001 and 2002, and the related condensed consolidated statements of cash flows for the nine months then ended. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to such condensed consolidated financial statements for them to be in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the condensed consolidated financial statements, the Company changed its method of accounting for stock based compensation issued to employees.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet of the Company as of December 31, 2001, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended (not presented herein); and in our report dated February 11, 2002 (March 29, 2002 as to Note 15, April 15, 2002 as to Notes 10 and 19 and August 5, 2002 as to Note 2), we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2001 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

DELOITTE & TOUCHE LLP

St. Louis, Missouri
November 6, 2002

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PREMCOR INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS
(amounts in millions, except share data)

	December 31, 2001	September 30, 2002
		(unaudited)
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 510.1	$ 156.3
Short-term investments	1.7	1.7
Cash and cash equivalents restricted for debt service	30.8	51.9
Accounts receivable, net of allowance of $1.3 and $3.2	148.3	200.0
Inventories	318.3	367.3
Prepaid expenses and other	52.3	30.7
Assets held for sale		61.2
Total current assets	1,061.5	869.1
PROPERTY, PLANT AND EQUIPMENT, NET	1,299.6	1,213.7
DEFERRED INCOME TAXES		78.8
OTHER ASSETS	148.7	130.9
	$ 2,509.8	$ 2,292.5
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 366.4	$ 441.4
Accrued expenses	95.4	92.2
Accrued taxes other than income	35.7	28.2
Current portion of long-term debt	81.4	15.6
Total current liabilities	578.9	577.4
LONG-TERM DEBT	1,391.4	909.7
DEFERRED INCOME TAXES	16.7	
OTHER LONG-TERM LIABILITIES	109.1	146.8
COMMITMENTS AND CONTINGENCIES		
MINORITY INTEREST	24.2	
EXCHANGEABLE PREFERRED STOCK ($0.01 par value per share; 250,000 shares authorized; 92,284 shares issued and outstanding in 2001)	94.8	
COMMON STOCKHOLDERS EQUITY:		
Common, $0.01 par value per share, 53,000,000 authorized, 25,720,589 issued and outstanding in 2001 and 150,000,000 authorized, 57,473,935 issued and outstanding in 2002; Class F Common, $0.01 par value, 7,000,000 authorized, 6,101,010 issued and outstanding in 2001	0.3	0.6
Paid-in capital	323.7	851.6
Accumulated deficit	(29.3)	(193.6)
Total common stockholders equity	294.7	658.6
	$ 2,509.8	$ 2,292.5

The accompanying notes are an integral part of these financial statements.

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PREMCOR INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited; amounts in millions, except per share data)

	For the Nine Months Ended September 30, 2001	For the Nine Months Ended September 30, 2002
NET SALES AND OPERATING REVENUES	$ 5,170.9	$ 4,807.1
EXPENSES:		
Cost of sales	4,133.7	4,342.8
Operating expenses	355.8	338.2
General and administrative expenses	45.3	40.8
Stock option compensation expense		9.9
Depreciation	39.6	35.7
Amortization	28.1	29.2
Refinery restructuring and other charges	176.2	172.9
	4,778.7	4,969.5
OPERATING INCOME (LOSS)	392.2	(162.4)
Interest and finance expense	(121.6)	(89.4)
Gain (loss) on extinguishment of long-term debt	8.7	(19.5)
Interest income	15.3	7.9
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST	294.6	(263.4)
Income tax (provision) benefit	(78.7)	99.9
Minority interest	(12.4)	1.7
INCOME (LOSS) FROM CONTINUING OPERATIONS	203.5	(161.8)
Loss from discontinued operations, net of income tax benefit of $5.5	(8.5)	
NET INCOME (LOSS)	195.0	(161.8)
Preferred stock dividends	(7.9)	(2.5)
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$ 187.1	$ (164.3)
Basic net income (loss) per common share:		
Income (loss) from continuing operations	$ 6.15	$ (3.57)
Discontinued operations	(0.27)	
Net income (loss)	$ 5.88	$ (3.57)
Weighted average common shares outstanding	31.8	46.0
Diluted net income (loss) per common share:		
Income (loss) from continuing operations	$ 5.67	$ (3.57)
Discontinued operations	(0.25)	
Net income (loss)	$ 5.42	$ (3.57)
Weighted average common shares outstanding	34.5	46.0

Pro forma for adoption of SFA No. 123:				
Income (loss) from continuing operations	$	203.1	$	(161.9)
Net income (loss) available to common stockholders	$	186.7	$	(164.4)
Net income (loss) per common share				
Basic	$	5.87	$	(3.57)
Diluted	$	5.41	$	(3.57)

The accompanying notes are an integral part of these financial statements.

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PREMCOR INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, amounts in millions)

	For the Nine Months Ended September 30,	
	2001	**2002**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 195.0	$ (161.8)
Discontinued operations	8.5	
Adjustments:		
Depreciation	39.6	35.7
Amortization	37.1	36.9
Deferred income taxes	71.2	(100.5)
Inventory write-down to market	8.7	
Stock option compensation expense		9.9
Minority interest	12.4	(1.7)
Refinery restructuring and other charges	125.3	103.6
Write-off of deferred financing costs	0.6	9.5
Write-off of equity investment		4.2
Other, net	0.4	15.8
Cash provided by (reinvested in) working capital		
Accounts receivable, prepaid expenses and other	41.9	(30.1)
Inventories	(12.0)	(49.0)
Accounts payable, accrued expenses, and taxes other than income	(105.4)	64.5
Cash and cash equivalents restricted for debt service	(30.6)	24.1
Net cash provided by (used in) operating activities of continuing operations	392.7	(38.9)
Net cash used in operating activities of discontinued operations	(2.5)	(3.3)
Net cash provided by (used in) operating activities	390.2	(42.2)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for property, plant and equipment	(57.8)	(64.1)
Expenditures for turnaround	(41.3)	(33.4)
Cash and cash equivalents restricted for investment in capital additions		5.5
Other	0.6	0.2
Net cash used in investing activities	(98.5)	(91.8)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Long-term debt and capital lease payments	(58.9)	(645.2)
Proceeds from the issuance of common stock, net		482.0
Cash and cash equivalents restricted for debt repayment		(45.2)
Deferred financing costs	(9.6)	(11.4)
Preferred stock dividend	(0.3)	
Net cash used in financing activities	(68.8)	(219.8)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	222.9	(353.8)
CASH AND CASH EQUIVALENTS, beginning of period	290.1	510.1

CASH AND CASH EQUIVALENTS, end of period	$ 513.0	$ 156.3

The accompanying notes are an integral part of these financial statements.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
September 30, 2002
(tabular dollar amounts in millions of U.S. dollars)

1. Basis of Preparation and Recent Developments

Premcor Inc. (individually, Premcor Inc. and collectively with its subsidiaries, the Company), a Delaware corporation, was incorporated in April 1999. Premcor Inc. owns all of the outstanding common stock of Premcor USA Inc. (Premcor USA). Premcor USA owns all of the outstanding common stock of The Premcor Refining Group Inc. (PRG). Following the completion of the restructuring described in Note 3, referred to as the Sabine restructuring, PRG owns all of the outstanding common stock of Sabine River Holding Corp. (Sabine). Sabine is the 1% general partner of Port Arthur Coker Company L.P. (PACC), a limited partnership, and the 100% owner of Neches River Holding Corp. (Neches), which is the 99% limited partner of PACC. PACC is the 100% owner of Port Arthur Finance Corp. (PAFC). The restructuring of Sabine as a wholly owned subsidiary of PRG constituted an exchange of ownership interest between entities under common control, and therefore was accounted for similar to a pooling of interests.

The Company is an independent petroleum refiner and supplier of unbranded transportation fuels, heating oil, petrochemical feedstocks, petroleum coke and other petroleum products in the United States. The Company owns and operates two refineries with a combined crude oil throughput capacity of 420,000 barrels per day (bpd). The refineries are located in Port Arthur, Texas and Lima, Ohio. The Company ceased operations at its 70,000 bpd Hartford, Illinois refinery in late September consistent with the Company s plan which was announced in February 2002.

On May 3, 2002, Premcor Inc. completed an initial public offering of 20.7 million shares of common stock. The initial public offering, plus the concurrent purchases of 850,000 shares in the aggregate by Thomas D. O Malley, the Company s chairman of the board, chief executive officer and president, and two independent directors of the Company, netted proceeds to Premcor Inc. of approximately $482 million. The proceeds from the offering were committed to retire debt of Premcor Inc. s subsidiaries. See Note 8 Long-term Debt for details on the use of these proceeds. Prior to the initial public offering, Premcor Inc. s common equity was privately held and controlled by Blackstone Capital Partners III Merchant Banking Fund L.P. and its affiliates (Blackstone). Premcor Inc. s other principal shareholder was a subsidiary of Occidental Petroleum Corporation (Occidental). As a result of these sales of Premcor Inc. s common stock and the Sabine restructuring described in Note 3, Blackstone s ownership was reduced to approximately 48% and Occidental s ownership was reduced to approximately 13%.

The accompanying unaudited condensed consolidated financial statements of the Company and its subsidiaries are presented pursuant to the rules and regulations of the United States Securities and Exchange Commission in accordance with the disclosure requirements for Form 10-Q. In the opinion of the management of the Company, the unaudited condensed consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) necessary to fairly state the results for the interim periods presented. Operating results for the nine months ended September 30, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. These unaudited financial statements should be read in conjunction with the audited financial statements and notes for the years ended December 31, 2001 and 2000. Certain reclassifications have been made to prior periods in order to conform to the current period presentation.

2. New and Proposed Accounting Standards

On January 1, 2002, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 142, *Goodwill and Other Intangible Assets,* and SFAS No. 144, *Accounting for the Impairment or Disposal of Long- Lived Assets.* The adoption of these standards did not have a material impact on the Company s financial position

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

and results of operations; however, SFAS No. 144 was utilized in the accounting for the Company s closure of the Hartford, Illinois refinery. See Note 4, Refinery Restructuring and Other Charges for details of the Hartford refinery shutdown.

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations.* SFAS No. 143 addresses when a liability should be recorded for asset retirement obligations and how to measure this liability. The initial recording of a liability for an asset retirement obligation will require the recording of a corresponding asset that will be required to be amortized. SFAS No. 143 is effective for fiscal years beginning after June 15, 2002. The Company is in the process of evaluating the impact of the adoption of this standard on its financial position and results of operations and believes that implementation will not have a material impact.

In April 2002, the FASB issued SFAS No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections.* SFAS 145 rescinds SFAS No. 4, *Reporting Gains and Losses from the Extinguishment of Debt;* SFAS No. 44, *Accounting for Intangible Assets of Motor Carriers;* and SFAS No. 64, *Extinguishment of Debt Made to Satisfy Sinking-Fund Requirements.* SFAS No. 145 also amends SFAS No. 13, *Accounting for Leases*, as it relates to sale-leaseback transactions and other transactions structured similar to a sale-leaseback as well as amends other pronouncements to make various technical corrections. The provisions of SFAS No. 145 as they relate to the rescission of SFAS No. 4 shall be applied in fiscal years beginning after May 15, 2002. The provision of this statement related to the amendment to SFAS No. 13 shall be effective for transactions occurring after May 15, 2002. All other provisions of this statement shall be effective for financial statements on or after May 15, 2002. As permitted by SFAS No. 145, the Company has elected early adoption of the rescission of SFAS No. 4. Accordingly, the Company has included the gain or loss on extinguishment of long-term debt in Income from continuing operations as opposed to as an extraordinary item, net of taxes, below Income from continuing operations in its Statement of Operations.

In June 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS No. 146 requires the recognition of liabilities at fair value that are associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Such liabilities include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing or other exit or disposal activities. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. The Company will adopt SFAS No. 146 for all restructuring, discontinued operations, plant closings or other exit or disposal activities initiated after December 31, 2002.

The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants has issued an exposure draft of a proposed statement of position (SOP) entitled *Accounting for Certain Costs and Activities Related to Property, Plant and Equipment*. If adopted as proposed, this SOP will require companies to expense as incurred turnaround costs, which it terms as the non-capital portion of major maintenance costs. Adoption of the proposed SOP would require that any existing unamortized turnaround costs be expensed immediately. If this proposed change were in effect at September 30, 2002, the Company would have been required to write-off unamortized turnaround costs of approximately $97 million. Unamortized turnaround costs will change in 2002 as maintenance turnarounds are performed and past maintenance turnarounds are amortized. If adopted in its present form, charges related to this proposed change would be taken in the first quarter of 2003 and would be reported as a cumulative effect of an accounting change, net of income tax, in the consolidated statements of operations.

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

3. Sabine Restructuring

On June 6, 2002, PRG and Sabine completed a series of transactions (the Sabine restructuring) that resulted in Sabine and its subsidiaries becoming wholly owned subsidiaries of PRG. Sabine, through its principal operating subsidiary, PACC, owns and operates a heavy oil processing facility, which is operated in conjunction with PRG s Port Arthur, Texas refinery. Prior to the Sabine restructuring, Sabine was 90% owned by Premcor Inc. and 10% owned by Occidental.

The Sabine restructuring was permitted by the successful consent solicitation of the holders of PAFC s 12½% Senior Notes. The Sabine restructuring was accomplished according to the following steps, among others:

Premcor Inc. contributed $225.6 million in proceeds from its initial public offering of common stock to Sabine. Sabine used the proceeds from the equity contribution, plus cash on hand, to prepay $221.4 million of its Bank Senior Loan Agreement and to pay a dividend of $141.4 million to Premcor Inc.;

Commitments under Sabine s senior secured bank loan, working capital facility, and certain insurance policies were terminated and related guarantees were released;

PRG s existing working capital facility was amended and restated to, among other things, permit letters of credit to be issued on behalf of Sabine;

Occidental exchanged its 10% interest in Sabine for 1,363,636 newly issued shares of Premcor Inc. common stock;

Premcor Inc. contributed its 100% ownership interest in Sabine to Premcor USA and Premcor USA, in turn, contributed its 100% ownership interest in Sabine to PRG; and

PRG fully and unconditionally guaranteed, on a senior unsecured basis, the payment obligations under the PAFC 12½% Senior Notes.

Premcor Inc. s acquisition of Occidental s 10% ownership in Sabine was accounted for under the purchase method. The purchase price was based on the exchange of 1,363,636 shares of Premcor Inc. common stock for the 10% interest in Sabine and was valued at $30.5 million or approximately $22 per share. The purchase price of the 10% minority interest in Sabine exceeded the book value by $8.0 million. Based on an appraisal of the Sabine assets, the excess of the purchase price over the book value of the minority interest, along with a $5.0 million deferred income tax adjustment, was recorded as an investment in property, plant and equipment and will be depreciated over the remaining useful lives of the related Sabine assets. The income tax adjustment reflected the temporary difference between the book and tax basis of property, plant and equipment related to the excess of the purchase price over book value. Because the purchase price did not exceed the fair value of the underlying assets, no goodwill was recognized.

As discussed in Note 1, the contribution of Premcor Inc. s 100% ownership interest in Sabine to PRG was an exchange of ownership interest between entities under common control, and therefore was accounted for at the book value of Sabine, similar to a pooling of interests.

PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

4. Refinery Restructuring and Other Charges

In 2002, the Company recorded refinery restructuring and other charges of $172.9 million, which consisted of the following:

a $137.4 million charge related to the shutdown of refining operations at the Hartford, Illinois refinery,

a $32.4 million charge related to the restructuring of the Company s management team, refinery operations and administrative functions,

income of $5.0 million related to the unanticipated sale of a portion of the Blue Island refinery assets previously written off,

a $2.5 million charge related to the termination of certain guarantees at PACC as part of the Sabine restructuring,

a $1.4 million loss related to idled assets held for sale, and

a $4.2 million write-down of Premcor Inc. s 5% interest in Clark Retail Group, Inc., the sole stockholder of Clark Retail Enterprises, Inc. (CRE). Premcor Inc. acquired an interest in Clark Retail Group, Inc. when PRG sold its retail business to CRE in 1999. Clark Retail Group, Inc. and CRE filed a petition to reorganize under Chapter 11 of the U.S. bankruptcy laws in October 2002.

In 2001, refinery restructuring and other charges of $176.2 million consisted of a $167.2 million charge related to the January 2001 closure of the Blue Island, Illinois refinery and a $9.0 million charge related to the write-off of idled coker units at the Port Arthur refinery. The write-off of the Port Arthur coker units included a charge of $5.8 million related to the net asset value of the idled cokers and a charge of $3.2 million for future environmental clean-up costs related to the coker unit site.

Hartford Refinery Closure

In late September 2002, the Company ceased operations at its Hartford refinery after concluding there was no economically viable method of reconfiguring the refinery to produce fuels meeting new gasoline and diesel fuel specifications mandated by the federal government. Despite ceasing operations, the Company continues to pursue all options, including the sale of the refinery, to mitigate the loss of jobs and refinery capacity in the Midwest.

Since the Hartford refinery operation had been only marginally profitable over the last 10 years and since substantial investment would be required to meet new required product specifications in the future, the Company s reduced refining capacity resulting from the shutdown is not expected to have a significant negative impact on net income or cash flow from operations. The only anticipated effect on net income and cash flow in the future will result from the actual shutdown process, including recovery of realizable asset value, and subsequent environmental site remediation, which will occur over a number of years. Unless there is a need to adjust the shutdown reserve in the future as discussed below, there should be no significant effect on net income beyond 2002.

A pretax charge of $137.4 million was recorded in 2002, which included $70.7 million of non-cash long-lived asset write-offs to reduce the refinery assets to their estimated net realizable value of $61.0 million. The net realizable value was determined by estimating the value of the assets in a sale or operating lease transaction and was recorded as a current asset on the balance sheet. In October 2002, we announced that we would continue to operate the Hartford terminal facility to accommodate our wholesale petroleum product distribution business. As a result, we reclassified the net book value of the terminal assets from assets held for sale to property, plant and equipment. This reduced the estimated net realizable value of the remaining refinery assets to $49.0 million. The Company has had preliminary discussions with third parties regarding a transaction for the refinery assets such a transaction, but there can be no assurance that one will be completed. In the event that a sale or lease transaction is not completed, the net realizable value may be less than $49.0 million and a further write-down may be

PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

required. In the second quarter of 2002, the Company completed an evaluation of its warehouse stock, catalysts, chemicals, and additives inventories, and the Company determined that a portion of these inventories would not be recoverable upon the closure or sale of the refinery. Accordingly, the Company wrote-down these assets by $3.2 million.

The total charge also included a reserve for future costs of $62.5 million as itemized below. The Hartford restructuring reserve balance and net cash activity as of September 30, 2002 is as follows:

	Initial Reserve	Net Cash Outlay	Reserve as of September 30, 2002
Employee severance	$ 16.6	$ 0.2	$ 16.4
Plant closure/equipment remediation	12.9	5.6	7.3
Site clean-up/environmental matters	33.0		33.0
	$ 62.5	$ 5.8	$ 56.7

Management adopted an exit plan that details the shutdown of the process units at the refinery and the subsequent environmental remediation of the site. The Company expects the majority of the process unit shutdown and hydrocarbon purging to be finalized in the fourth quarter of 2002. The Company terminated approximately 300 of 315 employees, both hourly (covered by collective bargaining agreements) and salaried, in October 2002. The site clean-up and environmental reserve takes into account costs that are reasonably foreseeable at this time. As the final disposition of the refinery is determined and a site remediation plan refined, further adjustments of the reserve may be necessary, and such adjustments may be material. The Company expects to spend approximately $20 million to $30 million in 2002 related to employee severance and the process unit shutdown and hydrocarbon purge.

Finally, the total charge included a $1.0 million reserve related to post-retirement benefits that were extended to certain employees who were nearing the retirement requirements. This liability was recorded in Other Long-term Liabilities on the balance sheet together with the Company s other post-retirement liabilities.

Management, Refinery Operations and Administrative Restructuring

In February 2002, the Company began the restructuring of its executive management team and subsequently its administrative functions with the hiring of Thomas D. O Malley as chairman, chief executive officer, and president and William E. Hantke as executive vice president and chief financial officer. In the first quarter of 2002, as a result of the resignation of the officers who previously held these positions, the Company recognized severance expense of $5.0 million and non-cash compensation expense of $5.8 million resulting from modifications of stock option terms. In addition, the Company incurred a charge of $5.0 million for the cancellation of a monitoring agreement with an affiliate of Blackstone.

In the second quarter of 2002, the Company commenced a restructuring of its St. Louis-based general and administrative operations and recorded a charge of $6.5 million for severance, outplacement and other restructuring expenses relating to the elimination of 107 hourly and salaried positions. In the third quarter of 2002, the Company announced plans to reduce its non-represented workforce at its Port Arthur, Texas and Lima, Ohio refineries and make additional staff reductions at its St. Louis administrative office. The Company recorded a charge of $10.1 million for severance, outplacement, and other restructuring expenses relating to the elimination of 140 hourly and salaried positions. Included in this charge is $1.3 million related to post-retirement benefits that were extended to certain employees who were nearing the retirement requirements. This liability was recorded in Other Long-term Liabilities on the balance sheet together with the Company s other post-

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PREMCOR INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

retirement liabilities. Reductions at the refineries occurred in October 2002 and those at the St. Louis office will take place by the end of the first quarter of 2003. The reserve relating to the refineries and St. Louis restructuring is as follows:

	Initial Reserve	Additional Reserve	Net Cash Outlay	Reserve at September 30, 2002
Refineries and St. Louis restructuring	$ 6.5	$ 8.8	$ 4.6	$ 10.7

The Company expects to spend approximately $11 million to $13 million in 2002 related to these refinery and St. Louis restructuring activities.

Blue Island Refinery Closure Reserve

In 2001, the Company recorded a pretax charge of $167.2 million related to the January 2001 closure of the Blue Island, Illinois refinery. The Blue Island restructuring reserve balance and net cash activity as of September 30, 2002 is as follows:

	Reserve as of December 31, 2001	Net Cash Outlay	Reserve as of September 30, 2002
Employee severance	$ 2.1	$ 2.1	$
Plant closure/equipment remediation	13.9	8.1	5.8
Site clean-up/environmental matters	20.5	3.9	16.6
	$ 36.5	$ 14.1	$ 22.4

The Company expects to spend approximately $15 million to $16 million in 2002 related to the reserve for future costs, with the remainder to be spent over the next several years. The Company is currently in discussions with governmental agencies concerning a remediation program, which it believes will likely lead to a final consent order and remediation plan. The Company does not expect these discussions to be concluded until 2003 at the earliest. The Company s site clean-up and environmental reserve takes into account costs that are reasonably foreseeable at this time, based on studies performed in conjunction with obtaining the insurance policy mentioned below. As the site remediation plan is finalized and work is performed, further adjustments of the reserve may be necessary.

In 2002, environmental risk insurance policies covering the Blue Island refinery site were procured and bound, with final policies expected to be issued within the first quarter of 2003. This insurance program will allow the Company to quantify and, within the limits of the policy, cap its cost to remediate the site, and provide insurance coverage from future third party claims arising from past or future environmental releases. The remediation cost overrun policy has a term of ten years and, subject to certain exceptions and exclusions, provides $25 million in coverage in excess of a self-insured retention amount of $26 million. The pollution legal liability policy provides for $25 million in aggregate coverage and per incident coverage in excess of a $100,000 deductible per incident. The Company believes this program also provides governmental agencies financial assurance that, once begun, remediation of the site will be completed in a timely and prudent manner.

5. Gain or Loss on Extinguishment of Long-Term Debt

In the nine months ended September 30, 2002, the Company recorded a loss on extinguishment of long-term debt of $19.5 million related to the repurchase of certain long-term debt as described in Note 8 Long-term Debt. The loss recorded for the nine months ended September 30, 2002 included premiums associated with the early repayment of long-term debt of $9.4 million, a write-off of unamortized deferred financing costs related to this

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

debt of $9.5 million, and the write-off of a prepaid premium for an insurance policy guaranteeing the interest and principal payments on Sabine s long-term debt of $0.6 million.

In the nine months ended September 30, 2001, the Company repurchased in the open market $21.3 million in face value of its 9 1/2% Senior Notes, $30.6 million in face value of its 10 7/8% Senior Notes, and $5.9 million in face value of its 11 1/2% Exchangeable Preferred Stock. As a result of these transactions, the Company recorded a gain of $8.7 million, which included discounts of $9.3 million offset by the write-off of deferred financing costs related to the notes.

6. Inventories

The carrying value of inventories consisted of the following:

	December 31, 2001	September 30, 2002
Crude oil	$ 77.0	$ 93.1
Refined products and blendstocks	218.7	253.4
Warehouse stock and other	22.6	20.8
	$ 318.3	$ 367.3

The market value of crude oil, refined products and blendstock inventories at September 30, 2002 was approximately $150 million (December 31, 2001 $5 million) above carrying value.

As of January 1, 2002, PACC changed its method of inventory valuation from first-in first-out (FIFO) to last-in first-out (LIFO) for crude oil and blendstock inventories. Management believes this change is preferable in that it achieves a more appropriate matching of revenues and expenses. The adoption of this inventory accounting method on January 1, 2002 did not have an impact on pretax earnings. The adoption of the LIFO method resulted in approximately $12.0 million less net income ($0.26 per basic and diluted share) for the nine months ended September 30, 2002 than if the FIFO method had been used for the same periods. Cost for warehouse stock continues to be determined under the FIFO method.

7. Other Assets

Other assets consisted of the following:

	December 31, 2001	September 30, 2002
Deferred turnaround costs	$ 97.9	$ 96.5
Deferred financing costs	32.6	27.0
Cash restricted for investment in capital additions	9.9	4.4
Investment in affiliates	4.7	0.5
Other	3.6	2.5
	$ 148.7	$ 130.9

Amortization of deferred financing costs for the nine months ended September 30, 2002 was $7.5 million (2001 $8.8 million) and was included in Interest and finance expense . In 2002, the Company incurred deferred financing costs of $1.1 million for fees to obtain a waiver related to insurance coverage required under PACC s common security agreement with certain bondholders and $10.3 million related to the consent solicitation process of the Sabine restructuring and subsequent registration of the PACC senior notes with the Securities & Exchange Commission. In the second quarter of 2002, the Company wrote-off $9.5 million of deferred financing costs as a result of the early repayment of long-term debt.

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8. Long-term Debt and Exchangeable Preferred Stock

Long-term debt and exchangeable preferred stock consisted of the following:

	December 31, 2001	September 30, 2002
8 5/8% Senior Notes due August 15, 2008 (8 5/8% Senior Notes)(1)	$ 109.8	$ 109.8
8 3/8% Senior Notes due November 15, 2007 (8 3/8% Senior Notes)(1)	99.6	99.6
8 7/8% Senior Subordinated Notes due November 15, 2007 (8 7/8% Senior Subordinated Notes)(1)	174.2	174.4
Floating Rate Term Loan due November 15, 2003 and 2004 (Floating Rate Loan)(1)	240.0	240.0
9 1/2% Senior Notes due September 15, 2004 (9 1/2% Senior Notes)(1)	150.4	
12 1/2% Senior Notes due January 15, 2009 (12 1/2% Senior Notes)(2)	255.0	250.7
Bank Senior Loan Agreement(2)	287.6	
10 7/8% Senior Notes due December 1, 2005 (10 7/8% Senior Notes)(3)	144.4	
11 1/2% Subordinated Debentures due October 1, 2009 (11 1/2% Subordinated Debentures)(3)		40.1
Ohio Water Development Authority Environmental Facilities Revenue Bonds due December 01, 2031 (Series 2001 Ohio Bonds)(1)	10.0	10.0
Obligations under capital leases(1)	1.8	0.7
	1,472.8	925.3
Less current portion of debt	81.4	15.6
Total long-term debt	$ 1,391.4	$ 909.7
Exchangeable Preferred Stock (3)	$ 94.8	$

(1) Issued or borrowed by PRG
(2) Issued or borrowed by PAFC
(3) Issued or borrowed by Premcor USA

In 2002, Premcor Inc. contributed $442.9 million of its initial public offering proceeds to its subsidiaries for the early redemption and repurchase of a portion of their outstanding long-term debt. In June 2002, PRG redeemed the remaining $150.4 million of its 9½% Senior Notes at par, and Premcor USA redeemed the remaining $144.4 million of its 10 7/8% Senior Notes, including a $5.2 million premium, from capital contributions received from Premcor Inc.

On April 1, 2002, Premcor USA exchanged all of its 11½% Exchangeable Preferred Stock for 11½% Subordinated Debentures. In 2002, Premcor USA purchased, in the open market, $57.5 million in aggregate principal amount of its 11½% Subordinated Debentures at a $3.3 million premium from capital contributions received from Premcor Inc.

In 2002, PACC made a $4.3 million principal payment on its 12½% Senior Notes. In January 2002, PACC made a $66.2 million principal payment on its Bank Senior Loan Agreement, of which $59.7 million represented a mandatory prepayment pursuant to the common security agreement and related secured account structure. In

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June 2002, as part of the Sabine restructuring, PACC prepaid the remaining balance of $221.4 million on the Bank Senior Loan Agreement at a $0.9 million premium, with cash on hand and an $84.2 million net capital contribution from Premcor Inc.

Prior to the Sabine restructuring, the common security agreement required that PACC carry insurance coverage with specified terms. Due to the effects of the events of September 11, 2001 on the insurance market, coverage meeting such terms was not available on commercially reasonable terms, and as a result, PACC s insurance program was not in full compliance with the required insurance coverage at December 31, 2001. PACC received a waiver from the requisite parties. Subsequently, the common security agreement has been amended and restated as part of the Sabine restructuring and the new provisions regarding insurance coverage take into consideration a changing economic environment and its effects on the insurance markets in general. Under the amended and restated common security agreement, PACC has some specific insurance requirements, but principally must ensure that coverage is consistent with customary standards in its industry. There is also a provision that allows for thirty days notice to requisite parties of any inability to comply with the specific terms without any event of a default. As of September 30, 2002, PACC was in compliance with the insurance coverage requirements of the amended and restated common security agreement.

9. Working Capital Facility

In March 2002, PRG received a waiver regarding the maintenance of the tangible net worth covenant related to its $650 million working capital credit agreement, which allows for the exclusion of $120 million of the pretax restructuring charge related to the closure of the Hartford refinery.

As part of the Sabine restructuring, Sabine terminated its insurance policy that guaranteed its Maya crude oil purchase obligations and its $35 million bank working capital facility that supported Sabine s non-Maya crude oil purchase obligations. In May 2002, PRG amended its $650 million working capital facility principally to allow for the inclusion of Sabine crude oil purchase obligations. As amended, the $650 million limit of the facility can be increased by $50 million, up to the borrowing base limitation, at the request of PRG and upon securing additional commitments. Also under the amendment, the borrowing base calculation was amended to include PACC inventory and the tangible net worth covenant was increased to $400 million from $150 million.

10. Stock Option Plans

In conjunction with the management change discussed in Note 4 above, Premcor Inc. adopted two new stock incentive plans. The 2002 Special Stock Incentive Plan was adopted in connection with the employment of Thomas D. O Malley and allows for the issuance of options for the purchase of Premcor Inc. common stock. Under this plan, options on 3,400,000 shares of Premcor Inc. common stock may be awarded. As of September 30, 2002, options for 2,950,000 shares of Premcor Inc. common stock had been granted, options for 2,200,000 shares at an exercise price of $10 per share and options for 750,000 shares at an exercise price of $22.50 per share. Options granted under this plan vest 1/3 on each of the first three anniversaries of the date of grant. The options for 750,000 shares referenced above were granted to Mr. O Malley pursuant to his employment agreement.

The 2002 Equity Incentive Plan was adopted to award key employees, directors, and consultants with various stock options, stock appreciation rights, restricted stock, performance-based awards and other common stock based awards of Premcor Inc. common stock. Under the 2002 Equity Incentive Plan, options for 1,500,000 shares of Premcor Inc. common stock may be awarded. As of September 30, 2002, options for 1,036,000 shares of Premcor Inc. common stock were granted as follows: options for 435,000 shares at an exercise price of $10 per share and options for 601,000 shares at an exercise price ranging from $18.50 per share to $26 per share.

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Options granted under this plan vest 1/3 on each of the first three anniversaries of the date of grant. These options included options for 100,000 shares granted to two directors pursuant to agreements with the Company.

During the second quarter of 2002, the Company elected to adopt the fair value based expense recognition provisions of SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123). The Company previously applied the intrinsic value based expense recognition provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees (APB No. 25). SFAS No. 123 provides that the adoption of the fair value based method is a change to a preferable method of accounting. As provided by SFAS No. 123, the stock option compensation expense is calculated based only on stock options granted in the year of election and thereafter. The fair value of these options was estimated on the grant date using the Black-Sholes option-pricing model with the following weighted average assumptions as of September 30, 2002: a) assumed risk-free rate of 5.06% per annum, b) expected life of 3.7 years, c) expected volatility of 38.9%, and d) no expected dividends. All stock options granted prior to January 1, 2002 continue to be accounted for under APB No. 25.

In the period of adoption of SFAS No. 123, the adoption of this fair value based method increased the Company s net loss by $0.6 million (less than $0.01 per basic share) and $0.8 million (less than $0.01 per basic share) for the three-month and six-month periods ended June 30, 2002, respectively. The effects of the adoption of SFAS No. 123 on loss from continuing operations, net loss available to common stockholders, and net loss per share for the three-month period ended March 31, 2002 are as follows:

Loss from continuing operations and net loss available to common stockholders:		
As reported	$	(99.5)
Revised for adoption of SFAS No. 123	$	(99.7)
Net loss per common share (in whole dollars):		
As reported	$	(3.13)
Revised for adoption of SFAS No. 123	$	(3.14)

Since nonvested awards issued to employees prior to January 1, 2002 continue to be accounted for using the intrinsic value based provisions of APB No. 25, employee stock-based compensation expense determined using the fair value based method applied prospectively is not necessarily indicative of future expense amounts when the fair value based method will apply to all outstanding nonvested awards. With respect to all stock option grants outstanding at September 30, 2002, the Company will record future non-cash stock option compensation expense and additional paid-in capital of $40.4 million over the applicable vesting periods of the grants.

11. Interest and Finance Expense

Interest and finance expense included in Premcor Inc. s statements of operations consisted of the following:

	For the Nine Months Ended September 30,			
	2001		2002	
Interest expense	$	113.5	$	83.4
Financing costs		11.9		10.6
Capitalized interest		(3.8)		(4.6)
	$	121.6	$	89.4

The Company s cash paid for interest for the nine months ended September 30, 2002 was $95.6 million (2001 $120.9 million), respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

12. Income Taxes

The Company received net cash income tax refunds during the nine months ended September 30, 2002 of $12.4 million (2001 $13.6 million net cash income tax payments).

The income tax provision on the income from continuing operations before income taxes for the nine months ended September 30, 2001 of $78.7 million for the Company included the effect of a reversal during the first quarter of 2001 of the remaining deferred tax valuation allowance of $30.0 million. The reversal of the remaining deferred tax valuation allowance resulted from the analysis of the likelihood of realizing the future tax benefit of federal and state tax loss carryforwards, alternative minimum tax credits and federal and state business tax credits.

13. Discontinued Operations

In 2001, the Company recorded a pretax charge of $14.0 million, $8.5 million net of income taxes, related to environmental liabilities of discontinued retail operations. This charge represented an increase in estimates regarding the Company s environmental clean-up obligation and was prompted by the availability of new information concerning site by site clean-up plans and changing postures of state regulatory agencies.

14. Earnings per share

The diluted share base for the nine months ended September 30, 2002 excluded incremental common stock equivalents of 2,027,715. These common stock equivalents were excluded due to their antidilutive effect as a result of the Company s net loss available to common stockholders. The dilutive shares related to employee stock options and shareholder warrants. The diluted weighted average shares outstanding for the nine months ended September 30, 2001 reflected the potential dilution that could have occurred if all outstanding warrants were exercised. In the second quarter of 2002, all outstanding shareholder warrants were exercised. In the earnings per share calculation, net income (loss) available to common stockholders includes the deduction of preferred stock dividends when applicable.

15. Commitments and Contingencies

Legal and Environmental

As a result of its activities, the Company is the subject of a number of material pending legal proceedings, including proceedings related to environmental matters. Set forth below is an update of developments during the nine months ended September 30, 2002 with respect to any such proceedings and with respect to any environmental proceedings that involve monetary sanctions of $100,000 or more and to which a governmental authority is a party.

Blue Island: Federal and State Enforcement. In September 1998, the federal government filed a complaint, *United States v. Clark Refining & Marketing, Inc.*, alleging that the Blue Island refinery violated federal environmental laws relating to air, water and solid waste. The Illinois Attorney General intervened in the case. The State of Illinois and Cook County had also brought an action, several years earlier, *People ex rel. Ryan v. Clark Refining & Marketing, Inc.*, also alleging violations under environmental laws. In 2002, the Company reached an agreement to settle both cases. The consent order in the state case was formally approved and entered by the state court judge on April 8, 2002, and the federal court approved the settlement on June 12, 2002. The

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

consent order in the federal case required payments totaling $6.25 million as civil penalties, which the Company paid on July 12, 2002, and requires limited ongoing monitoring at the now-idled refinery. The Company had previously accrued for this obligation in its legal and environmental reserves. The consent order in the state case requires an ongoing tank inspection program along with enhanced reporting obligations. The consent orders dispose of both the federal and state cases.

Legal and Environmental Reserves. As a result of its normal course of business, the Company is a party to a number of legal and environmental proceedings. As of September 30, 2002, the Company had accrued a total of approximately $99 million (December 31, 2001 $77 million), on an undiscounted basis, for legal and environmental-related obligations that may result from the matters noted above and other legal and environmental matters. As of September 30, 2002, this accrual included approximately $78 million (December 31, 2001 $53 million) for site clean-up and environmental matters associated with the Hartford and Blue Island refinery closures and retail sites. The Company is of the opinion that the ultimate resolution of these claims, to the extent not previously provided for, will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company. However, an adverse outcome of any one or more of these matters could have a material effect on quarterly or annual operating results or cash flows when resolved in a future period.

Environmental Standards for Products

Tier 2 Motor Vehicle Emission Standards. In February 2000, the Environmental Protection Agency (EPA) promulgated the Tier 2 Motor Vehicle Emission Standards Final Rule for all passenger vehicles, establishing standards for sulfur content in gasoline. These regulations mandate that the average sulfur content of gasoline for highway use produced at any refinery not exceed 30 ppm during any calendar year by January 1, 2006, phasing in beginning on January 1, 2004. The Company currently expects to produce gasoline under the new sulfur standards at the Port Arthur refinery prior to January 1, 2004 and, as a result of the corporate pool averaging provisions of the regulations, will not be required to meet the new sulfur standards at the Lima refinery until July 1, 2004, a six month deferral. A further delay in the requirement to meet the new sulfur standards at the Lima refinery through 2005 may be possible through the purchase of sulfur allotments and credits which arise from a refiner producing gasoline with a sulfur content below specified levels prior to the end of 2005, the end of the phase-in period. There is no assurance that sufficient allotments or credits to defer investment at the Lima refinery will be available, or if available, at what cost. The Company believes, based on current estimates and on a January 1, 2004 compliance date for both the Port Arthur and Lima refineries, that compliance with the new Tier 2 gasoline specifications will require capital expenditures for the Lima and Port Arthur refineries in the aggregate through 2005 of approximately $255 million. More than 95% of the total investment to meet the Tier 2 gasoline specifications is expected to be incurred during 2002 through 2004 with the greatest concentration of spending occurring in 2003 and early 2004.

Low Sulfur Diesel Standards. In January 2001, the EPA promulgated its on-road diesel regulations, which will require a 97% reduction in the sulfur content of diesel fuel sold for highway use by June 1, 2006, with full compliance by January 1, 2010. Regulations for off-road diesel requirements are pending. The Company estimates capital expenditures in the aggregate through 2006 required to comply with the diesel standards at its Port Arthur and Lima refineries, utilizing existing technologies, of approximately $245 million. More than 95% of the projected investment is expected to be incurred during 2004 through 2006 with the greatest concentration of spending occurring in 2005. Since the Lima refinery does not currently produce diesel fuel to on-road specifications, the Company is considering an acceleration of the low-sulfur diesel investment at the Lima refinery in order to capture this incremental product value. If the investment is accelerated, production of the low-sulfur fuel is possible by the first quarter of 2005.

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Maximum Achievable Control Technology. On April 11, 2002, the EPA promulgated regulations to implement Phase II of the petroleum refinery Maximum Achievable Control Technology rule under the federal Clean Air Act, referred to as MACT II, which regulates emissions of hazardous air pollutants from certain refinery units. The Company expects to spend approximately $45 million over the next three years related to these new regulations with most of the expenditures occurring in 2003 and 2004.

Other Commitments

Crude Oil Purchase Commitment. In 1999, the Company sold crude oil linefill in the pipeline system supplying the Lima refinery to Koch Supply and Trading L.P. or Koch. As part of the agreement with Koch, the Company was required to repurchase approximately 2.7 million barrels of crude oil in this pipeline system in September 2002. On October 1, 2002, Morgan Stanley Capital Group Inc. (MSCG), purchased the 2.7 million barrels of crude oil from Koch in lieu of the Company s purchase obligation. The Company has agreed to purchase those barrels of crude oil from MSCG upon termination of the agreement with them, at then current market prices as adjusted by certain predetermined contract provisions. The initial term of the contract continues until October 1, 2003, and thereafter, automatically renews for additional 30-day periods unless terminated by either party. The Company has hedged the economic price risk related to the repurchase obligation through the purchase of exchange-traded futures contracts.

Long-Term Crude Oil Contract. PACC is party to a long-term crude oil supply agreement with PMI Comercio Internacional, S.A. de C.V. (PMI), an affiliate of Petroleos Mexicanos, the Mexican state oil company, which supplies approximately 167,000 barrels per day of Maya crude oil. Under the terms of this agreement, PACC is obligated to buy Maya crude oil from PMI, and PMI is obligated to sell Maya crude oil to PACC. An important feature of this agreement is a price adjustment mechanism designed to minimize the effect of adverse refining margin cycles and to moderate the fluctuations of the coker gross margin, a benchmark measure of the value of coker production over the cost of coker feedstocks. This price adjustment mechanism contains a formula that represents an approximation of the coker gross margin and provides for a minimum average coker margin of $15 per barrel over the first eight years of the agreement, which began on April 1, 2001. The agreement expires in 2011.

On a monthly basis, the coker gross margin, as defined under this agreement, is calculated and compared to the minimum. Coker gross margins exceeding the minimum are considered a surplus while coker gross margins that fall short of the minimum are considered a shortfall. On a quarterly basis, the surplus and shortfall determinations since the beginning of the contract are aggregated. Pricing adjustments to the crude oil the Company purchases are only made when there exists a cumulative shortfall. When this quarterly aggregation first reveals that a cumulative shortfall exists, the Company receives a discount on its crude oil purchases in the next quarter in the amount of the cumulative shortfall. If thereafter, the cumulative shortfall incrementally increases, the Company receives additional discounts on its crude oil purchases in the succeeding quarter equal to the incremental increase. Conversely, if thereafter, the cumulative shortfall incrementally decreases, the Company repays discounts previously received, or a premium, on its crude oil purchases in the succeeding quarter equal to the incremental decrease. Cash crude oil discounts received by the Company in any one quarter are limited to $30 million, while the Company s repayment of previous crude oil discounts, or premiums, are limited to $20 million in any one quarter. Any amounts subject to the quarterly payment limitations are carried forward and applied in subsequent quarters.

As of September 30, 2002, a cumulative quarterly surplus of $61.7 million existed under the contract. As a result, to the extent the Company experiences quarterly shortfalls in coker gross margins going forward, the price it pays for Maya crude oil in succeeding quarters will not be discounted until this cumulative surplus is offset by future shortfalls.

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Insurance Expenses. The Company purchases insurance intending to protect against risk of loss from a variety of exposures common to the refining industry, including property damage, business interruptions, third party liabilities, workers compensation, marine activities, and directors and officers legal liability, among others. The Company employs internal risk management measurements, actuarial analysis, and peer benchmarking to assist in determining the appropriate limits, deductibles, and coverage terms for the Company. The Company believes the insurance coverages it currently purchases are consistent with customary insurance standards in the industry. The Company s major insurance policies renewed on October 1, 2002 with a one-year term. Due primarily to the continuing effects of the events of September 11, 2001 on the insurance market, certain coverage terms, including terrorism coverage, were restricted or eliminated at renewal, certain deductibles were raised, certain coverage limits were lowered, and overall premium rates increased by 23%. Higher insurance premium expenses will be reflected in the Company s results beginning in the fourth quarter. While the Company intends to continue purchasing insurance coverages consistent with customary insurance standards in the industry, future losses could exceed insurance policy limits or, under adverse interpretations, be excluded from coverage.

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PART II

INFORMATION NOT REQUIRED IN THE PROSPECTUS

Item 13. Other Expenses of Issuance and Distribution

The estimated expenses payable by Premcor Inc. in connection with the offering described in this Registration Statement (other than underwriting discounts and commissions) are as follows:

SEC registration fee	$	26,585
NASD filing fee		30,500
NYSE listing fees		100,000
Printing and engraving expenses		250,000
Accounting fees and expenses		75,000
Legal fees and expenses		250,000
Blue Sky fees and expenses		10,000
Transfer agent and registrar fees		10,000
Miscellaneous		247,915
Total	$	1,000,000

Each of the amounts set forth above, other than the SEC registration fee and the NASD filing fee, is an estimate.

Item 14. Indemnification of Directors and Officers

Section 145 of the Delaware General Corporation Law provides that a corporation may indemnify directors and officers as well as other employees and individuals against expenses (including attorneys fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with any threatened, pending or completed actions, suits or proceedings in which such person is made a party by reason of such person being or having been a director, officer, employee or agent to the Registrant. The Delaware General Corporation Law provides that Section 145 is not exclusive of other rights to which those seeking indemnification may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise. Article VI of the Registrant s bylaws provides for indemnification by the Registrant of its directors, officers and employees to the fullest extent permitted by the Delaware General Corporation Law.

Section 102(b)(7) of the Delaware General Corporation Law permits a corporation to provide in its certificate of incorporation that a director of the corporation shall not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except for liability (i) for any breach of the director s duty of loyalty to the corporation or its stockholders, (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, (iii) for unlawful payments of dividends or unlawful stock repurchases, redemptions or other distributions or (iv) for any transaction from which the director derived an improper personal benefit. The Registrant s Amended and Restated Certificate of Incorporation provides for such limitation of liability to the fullest extent permitted by the Delaware General Corporation Law.

The Registrant expects to maintain standard policies of insurance under which coverage is provided (a) to its directors and officers against loss arising from claims made by reason of breach of duty or other wrongful act, and (b) to the Registrant with respect to payments that may be made by the Registrant to such officers and directors pursuant to the above indemnification provision or otherwise as a matter of law.

The proposed form of Underwriting Agreement filed as Exhibit 1 to this Registration Statement provides for indemnification of directors and officers of the Registrant by the underwriters against certain liabilities.

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Item 15. Recent Sales of Unregistered Securities

The Registrant has issued the following securities within the past three years without registration under the Securities Act of 1933, as amended:

(a) On April 27, 1999, Blackstone; Paul D. Melnuk; Marshall Cohen; Justin Investment Two, LLC; and Barrick Gold Corporation received 13,500,000 shares; 37,509 shares; 65,656 shares; 16,666 shares; and 213,654 shares, respectively, of the Registrant s common stock, and Occidental received 6,101,010 shares of the Registrant s Class F common stock, pursuant to a Share Exchange Agreement, dated as of April 27, 1999 by and among the holders of common stock of Premcor USA Inc. and the Registrant (the Share Exchange Agreement), in exchange for the equivalent number of shares of common stock of Premcor USA Inc. previously held by each of the purchasers.

(b) In August 1999, the Registrant issued to Blackstone warrants to purchase 2,430,000 shares of its common stock at a price of $0.09 per share in connection with capital contributions made in connection with the Port Arthur heavy oil upgrade project. In connection with, and effective upon completion of, its initial public offering in May 2002, Blackstone received 2,430,000 shares of the Registrant s common stock upon the exercise of such warrants, in accordance with a Warrant Exercise and Share Exchange Agreement among Blackstone, Occidental, Sabine River Holding Corp. and the Registrant (the Warrant Exercise Agreement).

(c) In connection with, and effective upon completion of, its initial public offering in May 2002, Occidental received 6,371,010 shares of the Registrant s common stock upon the conversion of 6,371,010 shares of the Registrant s Class F Common Stock into shares of the Registrant s common stock pursuant to the Warrant Exercise Agreement. Of the 6,371,010 shares of the Registrant s Class F Common Stock, (a) 6,101,010 shares were issued to Occidental pursuant to the Share Exchange Agreement, as described above, and (b) the remaining 270,000 shares were held by Occidental as a result of the following series of contemporaneous transactions pursuant to the Warrant Exercise Agreement: (i) the exercise of warrants held by Occidental to purchase 30,000 shares of common stock of Sabine River Holding Corp.; and (ii) the exchange of such Sabine River Holding Corp. common stock for 270,000 shares of our Class F Common Stock pursuant to the Share Exchange Agreement.

(d) On June 6, 2002, in connection with the Sabine restructuring, Occidental exchanged its 10% interest in Sabine River Holding Corp. for 1,363,636 newly issued shares of the Registrant s common stock. As a result, Sabine became an indirect wholly-owned subsidiary of the Registrant. The purchase price was based on a value of $30.5 million, or approximately $22 per share, for the 10% interest.

(e) Premcor Inc. has from time to time issued securities to various people pursuant to its stock incentive plans.

All such sales of securities were made under an exemption from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended, as transactions by an issuer not involving a public offering.

On April 29, 2002, Premcor Inc. s Registration Statement on Form S-1 (File No. 333-70314) was declared effective by the Securities and Exchange Commission allowing for an initial public offering of its common stock. A total of 20.7 million shares of Premcor Inc. s common stock were registered and sold in this offering at an offering price of $24.00 per share, for aggregate offering proceeds of $496.8 million, including 2.7 million shares sold pursuant to the underwriters over-allotment option. Premcor Inc. incurred $31.0 million in underwriters fees and $3.2 million in other fees and expenses in connection with the offering, yielding net proceeds of $462.6 million. Morgan Stanley and Credit Suisse First Boston served as managing underwriters for the offering.

On April 30, 2002, Premcor Inc. filed a Registration Statement on Form S-8 to register a total of 8.0 million shares of its common stock. Of those shares, concurrently with the closing of the initial public offering in May 2002, 750,000 shares were sold to Thomas D. O Malley, Premcor Inc. s chairman of the board, chief executive

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officer and president, and 50,000 shares each were sold to two directors, Jefferson F. Allen and Wilkes McClave III, of Premcor Inc. The shares were sold at a price per share of $22.50, which was the initial public offering price per share less the underwriting commission per share. Premcor Inc. received proceeds of approximately $19.1 million from these sales. The net proceeds from the initial public offering and the other sales described above were committed to retire long-term debt of Premcor Inc. s subsidiaries. As of September 30, 2002, $446.5 million of the net proceeds had been used to redeem and repurchase outstanding long-term debt securities of Premcor Inc. s subsidiaries. The remaining 7.1 million shares registered under this statement are reserved for issuance under our three stock incentive plans.

Item 16. Exhibits and Financial Statement Schedules

(a) *Exhibits*

Exhibit Number	Description
1**	Form of Underwriting Agreement
3.01	Amended and Restated Certificate of Incorporation of Premcor Inc. (Incorporated by reference to Exhibit 3.1 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
3.02	Amended and Restated By Laws of Premcor Inc. (Incorporated by reference to Exhibit 3.2 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
4.01	Indenture, dated as of August 19, 1999, among PAFC, PACC, Sabine, Neches, HSBC Bank USA, as Capital Markets Trustee and Deutsche Bank Americas Trust Company (f/k/a Bankers Trust Company), as Collateral Trustee (Incorporated by reference to Exhibit 4.01 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
4.02	First Supplemental Indenture, dated as of June 6, 2002, among PAFC, PACC, Sabine, Neches, PRG, HSBC Bank USA, as Capital Markets Trustee and Deutsche Bank Trust Company Americas, as Collateral Trustee (Incorporated by reference to Exhibit 4.1 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).
4.03	Form of 12.50% Senior Secured Notes due 2009 (the Exchange Note) (included as part of Exhibit 4.02 hereto)
4.04	Registration Rights Agreement, dated as of June 6, 2002, among PAFC, PACC, Sabine, Neches, PRG and HSBC Bank USA, as Capital Markets Trustee (Incorporated by reference to Exhibit 4.3 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).
4.05	Amended and Restated Common Security Agreement, dated as of June 6, 2002, among PAFC, PACC, Sabine, Neches, PRG, Deutsche Bank Trust Company Americas, as Collateral Trustee and Depositary Bank, and HSBC Bank USA, as Capital Markets Trustee (Incorporated by reference to Exhibit 4.2 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).
4.06	Amended and Restated Transfer Restrictions Agreement, dated as of June 6, 2002, among PAFC, PACC, Premcor Inc., Sabine, Neches, Deutsche Bank Trust Company Americas, as Collateral Trustee, and HSBC Bank USA, as Capital Markets Trustee (Incorporated by reference to Exhibit 4.4 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).
4.07	Equity Contribution Agreement, dated as of June 6, 2002, among Premcor Inc., Premcor USA Inc., and PRG (Incorporated by reference to Exhibit 4.5 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).

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Exhibit Number	Description
4.08	Indenture, dated as of August 10, 1998, between PRG (f/k/a Clark Refining & Marketing, Inc. and Clark Oil & Refining Corporation) and Bankers Trust Company, as Trustee, including the form of 8 $^{5}/8$% Senior Notes due 2008 (Incorporated by reference to Exhibit 4.1 filed with PRG s Registration Statement on Form S-4 (Registration No. 333-64387)).
4.09	Indenture, dated as of November 21, 1997, between PRG (f/k/a Clark Refining & Marketing, Inc. and Clark Oil & Refining Corporation) and Bankers Trust Company, as Trustee, including the form of 8 $^{3}/8$% Senior Notes due 2007 (Incorporated by reference to Exhibit 4.5 filed with PRG s Registration Statement on Form S-4 (Registration No. 333-42431)).
4.10	Indenture, dated as of November 21, 1997, between PRG (f/k/a Clark Refining & Marketing, Inc. and Clark Oil & Refining Corporation) and Marine Midland Bank, including the form of 8 $^{7}/8$% Senior Subordinated Notes due 2007 (Incorporated by reference to Exhibit 4.6 filed with PRG s Registration Statement on Form S-4 (Registration No. 333-42431)).
4.11	Supplemental Indenture, dated as of November 21, 1997, between PRG (f/k/a Clark Refining & Marketing, Inc. and Clark Oil & Refining Corporation) and Marine Midland Bank (Incorporated by reference to Exhibit 4.61 filed with PRG s Registration Statement on Form S-4 (Registration No. 333-42431)).
4.12	Indenture, dated as of October 1, 1997, between Premcor USA Inc. (f/k/a Clark USA, Inc.) and Bankers Trust Company, as Trustee, including form of 11 $^{1}/2$% Subordinated Exchange Debentures due 2009 (Incorporated by reference to Exhibit 4.2 filed with Premcor USA Inc. (f/k/a Clark USA, Inc.) Registration Statement on Form S-4 (Registration No. 333-42457)).
4.13	Supplemental Indenture, dated as of August 10, 1998, to Indenture, dated as of October 1, 1997, between Premcor USA Inc. (formerly known as Clark USA, Inc.) and Bankers Trust Company, as Trustee (Incorporated by reference to Exhibit 4.4 filed with Premcor USA Inc. s (f/k/a Clark USA, Inc.) Form 10-K for the year ended December 31, 1998 (File No. 1-13514)).
4.14	Stockholders Agreement, dated as of August 4, 1999, among Sabine River Holding, Premcor Inc. (f/k/a Clark Refining Holdings Inc.) and Occidental Petroleum Corporation (Incorporated by reference to Exhibit 4.18 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
4.15	Second Amended and Restated Stockholders Agreement, dated as of November 3, 1997, between Premcor USA Inc. (f/k/a Clark USA, Inc.) and Occidental C.O.B. Partners (Incorporated by reference to Exhibit 4.19 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
4.16	Stockholder Agreement, dated as of March 9, 1999, among Premcor Inc. (f/k/a Clark Refining Holdings Inc.), BCP III and Marshall A. Cohen (Incorporated by reference to Exhibit 4.20 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
4.17	Registration Rights Agreement, dated as of April 16, 2002, between BCP III, BOCP III and BFIP III and Premcor Inc. (Incorporated by reference to Exhibit 4.21 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
5**	Opinion of Stroock & Stroock & Lavan LLP as to the legality of the securities being registered.
10.01	Services and Supply Agreement, dated as of August 19, 1999, between PACC and PRG (f/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.08 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.02	Product Purchase Agreement, dated as of August 19, 1999, between PACC and PRG (f/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.09 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).

Exhibit Number	Description
10.03	Hydrogen Supply Agreement, dated as of August 1, 1999, between PACC and Air Products and Chemicals, Inc. (Incorporated by reference to Exhibit 10.10 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.04	First Amendment, dated March 1, 2000, to the Hydrogen Supply Agreement, dated as of August 1, 1999, between PACC and Air Products and Chemicals, Inc. (Incorporated by reference to Exhibit 10.1 filed with Sabine s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 333-92871)).
10.05	Second Amendment, dated June 1, 2001, to the Hydrogen Supply Agreement, dated as of August 1, 1999, between PACC and Air Products and Chemicals, Inc. (Incorporated by reference to Exhibit 10.2 filed with Sabine s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001 (File No. 333-92871)).
10.06	Coker Complex Ground Lease, dated as of August 19, 1999, between PACC and PRG (f/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.11 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.07	Ancillary Equipment Site Lease, dated as of August 19, 1999, between PACC and PRG (f/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.12 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.08	Assignment and Assumption Agreement, dated as of August 19, 1999, between PACC and PRG (f/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.13 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.09	Maya Crude Oil Sale Agreement, dated as of March 10, 1998, between PRG (f/k/a Clark Refining & Marketing) and P.M.I. Comercio Internacional, S.A. de C.V., as amended by the First Amendment and Supplement to the Maya Crude Oil Sales Agreement, dated as of August 19, 1999 (included as Exhibit 10.10 hereto), and as assigned by PRG to PACC pursuant to the Assignment and Assumption Agreement, dated as of August 19, 1999 (included as Exhibit 10.08 hereto) (Incorporated by reference to Exhibit 10.14 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.10	First Amendment and Supplement to the Maya Crude Oil Sales Agreement, dated as of August 19, 1999 (Incorporated by reference to Exhibit 10.15 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.11	Guarantee Agreement, dated as of March 10, 1998, between PRG (f/k/a Clark Refining & Marketing) and Petroleos Mexicanos, the Mexican national oil company, as assigned by PRG to PACC as of August 19, 1999 pursuant to the Assignment and Assumption Agreement, dated as of August 19, 1999 (included as Exhibit 10.08 hereto) (Incorporated by reference to Exhibit 10.16 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-92871)).
10.12	Amendment No. 2, dated as of May 29, 2002, to the Amended and Restated Credit Agreement, dated as of August 23, 2001, among PRG, Deutsche Bank Trust Company Americas, as Administrative Agent and Collateral Agent, TD Securities (USA) Inc., as Syndication Agent, Fleet National Bank, as Documentation Agent, and other financial institutions party hereto (Incorporated by reference to Exhibit 10.1 filed with PRG s Current Report on Form 8-K filed with the Commission on June 20, 2002 (File No. 001-11392)).
10.13	Amended and Restated Credit Agreement, dated as of August 23, 2001, among PRG, Deutsche Banc Alex. Brown Inc., as lead arranger, Deutsche Bank Trust Company Americas (f/k/a Bankers Trust Company), as Administrative Agent and Collateral Agent, TD Securities (USA) Inc., as Syndication Agent, Fleet National Bank, as Documentation Agent, and the other financial institutions party thereto (Incorporated by reference to Exhibit 10.1 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 33-70314)).

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Exhibit Number	Description
10.14	First Amended and Restated Credit Agreement, dated as of August 10, 1998, among PRG (f/k/a Clark Refining & Marketing, Inc. and Clark Oil & Refining Corporation), as Borrower, Goldman Sachs Credit Partners L.P., as Arranger, Syndication Agent and Administrative Agent, and State Street Bank & Trust Company of Missouri, N.A., as Paying Agent (Incorporated by reference to Exhibit 10.15 filed with PRG s Registration Statement on Form S-4 (Registration No. 333-64387)).
10.15	Asset Contribution and Recapitalization Agreement, dated as of May 8, 1999, by and among Premcor USA Inc. (f/k/a Clark USA, Inc.), PRG (f/k/a/ Clark Refining & Marketing, Inc.), Clark Retail Enterprises, Inc. (f/k/a OTG (Holdings), Inc. and OTG Inc.) and CM Acquisition, Inc. (Incorporated by reference to Exhibit 10.0 filed with the PRG (f/k/a Clark Refining & Marketing, Inc.) Quarterly Report on Form 10-Q for the quarter ended March 31, 1999 (File No. 1-11392)).
10.16	Amendment to Asset Contribution and Recapitalization Agreement, dated as of July 8, 1999, by and among Premcor USA Inc. (f/k/a Clark USA, Inc.), PRG (f/k/a/ Clark Refining Marketing, Inc.), Clark Retail Enterprises, Inc. (f/k/a OTG (Holdings), Inc. and OTG, Inc.) and CM Acquisition, Inc. (Incorporated by reference to Exhibit 10.16 filed with the PRG (f/k/a Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2000 (File No. 1-11392)).
10.17	Premcor Inc. (f/k/a Clark Refining Holdings Inc.) 1999 Stock Incentive Plan (Incorporated by reference to Exhibit 10.20 filed with PRG s Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 1-11392)).
10.18	Premcor Pension Plan (Incorporated by reference to Exhibit 10.14 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.19	Premcor Inc. Senior Executive Retirement Plan (Incorporated by reference to Exhibit 10.15 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.20	Premcor Retirement Savings Plan (Incorporated by reference to Exhibit 10.16 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.21	First Amendment to the Premcor Retirement Savings Plan (Incorporated by reference to Exhibit 10.17 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.22	Premcor Pension Restoration Plan (Incorporated by reference to Exhibit 10.18 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.23	Premcor Inc. Long Term Incentive Plan (Incorporated by reference to Exhibit 10.8 filed with the PRG (f/k/a Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2000 (File No. 1-11392)).
10.24	Employment Agreement, dated as of January 30, 2002, of Thomas D. O Malley (Incorporated by reference to Exhibit 10.13 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.25	First Amendment to Employment Agreement, dated March 18, 2002, of Thomas D. O Malley (Incorporated by reference to Exhibit 10.14 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.26	Letter Agreement, dated November 13, 2002, amending Employment Agreement of Thomas D. O Malley (Incorporated by reference to Exhibit 10.26 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.27	Amended and Restated Employment Agreement, dated as of June 1, 2002, of William E. Hantke (Incorporated by reference to Exhibit 10.3 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).

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Exhibit Number	Description
10.28	Amended and Restated Employment Agreement, dated as of June 1, 2002, of Henry M. Kuchta (Incorporated by reference to Exhibit 10.4 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.29	Amended and Restated Employment Agreement, dated as of June 1, 2002, of Joseph D. Watson (Incorporated by reference to Exhibit 10.6 filed with the PRG Quarterly Report on Form 10-Q for the quarter ended June 30, 2002 (File No. 1-11392)).
10.30	Termination Agreement, dated as of January 31, 2002, between Premcor Inc. and William C. Rusnack (Incorporated by reference to Exhibit 10.39 filed with Premcor Inc. s Registration Statement on Form S-1/A (Registration No. 333-70314)).
10.31	Termination Agreement, dated as of January 31, 2002, between Premcor Inc. and Ezra C. Hunt (Incorporated by reference to Exhibit 10.40 filed with Premcor Inc. s Registration Statement on Form S-1/A (Registration No. 333-70314)).
10.32	Premcor 2002 Equity Incentive Plan (Incorporated by reference to Exhibit 10.19 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.33	Premcor 2002 Special Stock Incentive Plan (Incorporated by reference to Exhibit 10.20 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.34	Letter Agreement, dated as of February 1, 2002, between Premcor Inc. and Wilkes McClave III (Incorporated by reference to Exhibit 10.21 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.35	Letter Agreement, dated as of February 1, 2002, between Premcor Inc. and Jefferson F. Allen (Incorporated by reference to Exhibit 10.22 filed with PRG s (f/k/a/ Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2001 (File No. 1-11392)).
10.36	Form of Indemnity Agreement (Incorporated by reference to Exhibit 10.36 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.37	Employment Agreement, dated as of September 16, 2002, of James R. Voss (Incorporated by reference to Exhibit 10.37 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.38	Employment Agreement, dated as of October 1, 2002, of Michael D. Gayda (Incorporated by reference to Exhibit 10.37 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.39	Separation Agreement and General Release, dated as of November 1, 2002, between Premcor Inc. and Jeffry N. Quinn (Incorporated by reference to Exhibit 10.38 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.40	Form of Letter Agreement, dated October 28, 2002, amending Employment Agreements of James R. Voss and Michael D. Gayda and Amended and Restated Employment Agreements of William E. Hantke, Henry M. Kuchta and Joseph D. Watson (Incorporated by reference to Exhibit 10.39 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.41	Form of Letter Agreement, dated November 13, 2002, amending Employment Agreements of Thomas D. O Malley, James R. Voss and Michael D. Gayda and Amended and Restated Employment Agreements of William E. Hantke, Henry M. Kuchta and Joseph D. Watson (Incorporated by reference to Exhibit 10.40 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).

Exhibit Number	Description
10.42	Form of Change-In-Control, Severance and Retention Agreement between Premcor Inc. and sixteen of its officers and other key employees (other than its executive officers) (Incorporated by reference to Exhibit 10.12 filed with the PRG (f/k/a Clark Refining & Marketing, Inc.) Annual Report on Form 10-K for the year ended December 31, 2000 (File No. 1-11392)).
10.43	Terminal Services Agreement, dated as of January 14, 2000, between Millennium Terminal Company, L.P. and PRG (a/k/a Clark Refining & Marketing, Inc.) (Incorporated by reference to Exhibit 10.26 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
10.44	Crude Oil Sale and Supply Agreement effective as of September 13, 2002 by and between PRG and Morgan Stanley Capital Group Inc. (Incorporated by reference to Exhibit 10.4 filed with PRG's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002).
10.45	Amendment to Crude Oil Sale and Supply Agreement, dated September 13, 2002 by and between PRG and Morgan Stanley Capital Group Inc. (Incorporated by reference to Exhibit 10.5 filed with PRG s Quarterly Report on Form 10-Q for the quarter ended September 30, 2002).
10.46	Supply and Terminalling Agreement, dated November 8, 1999, by and among PRG (f/k/a Clark Refining & Marketing, Inc.), Equiva Trading Company, Equilon Enterprises LLC and Motiva Enterprises LLC (Incorporated by reference to Exhibit 10.31 filed with Premcor Inc. s Registration Statement on Form S-1 (Registration No. 333-70314)).
10.47	Asset Purchase and Sale Agreement, dated as of November 25, 2002, among Williams Refining & Marketing, L.L.C., Williams Generating Memphis, L.L.C., Williams Memphis Terminal, Inc., Williams Petroleum Pipeline Systems, Inc. and Williams Mid-South Pipelines, LLC, as Sellers, The Williams Companies, Inc., as Sellers Guarantor, The Premcor Refining Group Inc. (PRG), as Purchaser, and Premcor Inc., as Purchaser s Guarantor (Incorporated by reference to Exhibit 2.01 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
10.48	Crack Spread Retained Interest Agreement, dated as of November 25, 2002, between Williams Refining & Marketing, L.L.C. and PRG (Incorporated by reference to Exhibit 2.02 filed with PAFC s Registration Statement on Form S-4 (Registration No. 333-99981)).
15*	Awareness letter dated January 22, 2003, from Deloitte & Touche LLP regarding the unaudited interim financial information for September 30, 2002 and 2001.
21**	Subsidiaries of the Registrant.
23.01**	Consent of Stroock & Stroock & Lavan LLP (contained in Exhibit 5).
23.02*	Consent of Deloitte & Touche LLP.
24.01**	Power of Attorney (included on signature page).
24.02**	Power of Attorney for Mr. Friedman.

* Filed herewith.
** Previously filed.

(b) *Financial Statement Schedules*

See Schedule II Valuation and Qualifying Accounts contained on page F-40. All other schedules are omitted as the information is not required or is included in the Registrant s financial statements and related notes.

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Item 17. Undertakings

(a) Insofar as indemnification for liabilities arising under the Securities Act of 1933, as amended, (the Securities Act), may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the Registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

(b) The undersigned Registrant hereby undertakes to provide to the underwriter at the closing specified in the underwriting agreement, certificates in such denominations and registered in such names as required by the underwriter to permit prompt delivery to each purchaser.

(c) The undersigned Registrant hereby undertakes that:

(1) For purposes of determining any liability under the Securities Act, the information omitted from the form of prospectus filed as part of this Registration Statement in reliance upon Rule 430A and contained in a form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this Registration Statement as of the time it was declared effective.

(2) For the purpose of determining any liability under the Securities Act, each post-effective amendment that contains a form of prospectus shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

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SIGNATURES

Pursuant to the requirements of the Securities Act of 1933, Premcor Inc. certifies that it has duly caused this Registration Statement or amendment thereto to be signed on its behalf by the undersigned, thereunto duly authorized, in Greenwich, CT on January 23, 2003.

PREMCOR INC.

By: /s/ DENNIS R. EICHHOLZ

Name: **Dennis R. Eichholz**
Title: **Senior Vice President Finance and Controller (principal accounting officer)**

Pursuant to the requirements of the Securities Act of 1933, this Registration Statement or amendment thereto has been signed below by the following persons in the capacities and on the dates indicated.

Signature	Title	Date
* **Thomas D. O Malley**	President, Chief Executive Officer and Chairman of the Board (principal executive officer)	January 23, 2003
* **William E. Hantke**	Executive Vice President and Chief Financial Officer (principal financial officer)	January 23, 2003
/s/ DENNIS R. EICHHOLZ **Dennis R. Eichholz**	Senior Vice President Finance and Controller (principal accounting officer)	January 23, 2003
* **David I. Foley**	Director	January 23, 2003
* **Robert L. Friedman**	Director	January 23, 2003
* **Richard C. Lappin**	Director	January 23, 2003
* **Stephen I. Chazen**	Director	January 23, 2003
* **Marshall A. Cohen**	Director	January 23, 2003
* **Jefferson F. Allen**	Director	January 23, 2003
Wilkes McClave III	Director	January 23, 2003

*By: /s/ Dennis R. Eichholz

Name: Dennis R. Eichholz
Attorney-in-Fact