

PREMCOR INC
Form 10-Q
May 01, 2003
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2003

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

Commission File Number	Exact Name of Registrant as Specified in its Charter, Principal Office Address and Telephone Number	State of Incorporation	I.R.S. Employer Identification No.
1-16827	Premcor Inc. 1700 East Putnam Avenue, Suite 500 Old Greenwich, Connecticut 06870 (203) 698-7500	Delaware	43-1851087

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1-11392 The Premcor Refining Group Inc. Delaware 43-1491230

1700 East Putnam Avenue, Suite 500

Old Greenwich, Connecticut 06870

(203) 698-7500

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Premcor Inc.	Yes <input type="checkbox"/>	No <input type="checkbox"/>
The Premcor Refining Group Inc.	Yes <input type="checkbox"/>	No <input type="checkbox"/>

Indicate by check mark if the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

Number of shares of the registrant's common stock (only one class for each registrant) outstanding as of April 15, 2003:

Premcor Inc.	74,085,860 shares
The Premcor Refining Group Inc.	100 shares (100% owned by Premcor USA Inc., a direct wholly owned subsidiary of Premcor Inc.)

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March 31, 2003

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FORM 10-Q PART I. FINANCIAL INFORMATION

This Quarterly Report on Form 10-Q represents a combined report for two registrants, Premcor Inc. and its indirectly wholly owned subsidiary The Premcor Refining Group Inc., or PRG. PRG is the principal operating company and together with its wholly owned subsidiary, Sabine River Holding Corp. and its subsidiaries, or Sabine, owns and operates three refineries. Sabine's principal operating company is Port Arthur Coker Company L.P., or PACC. The results of operations for Premcor Inc. principally reflect the results of operations of PRG, except for some pipeline operations and long-term debt held at Premcor USA Inc., PRG's parent company, and some general and administrative costs and interest income at stand-alone Premcor Inc. Included in this Quarterly Report on Form 10-Q are balance sheets, statements of operations, and statements of cash flows for the applicable periods for Premcor Inc. and PRG. The information reflected in the combined, consolidated footnotes are equally applicable to both companies except where indicated otherwise.

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ITEM 1. FINANCIAL STATEMENTS

INDEPENDENT ACCOUNTANTS REPORT

To the Board of Directors of Premcor Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Premcor Inc. and subsidiaries (the Company) as of March 31, 2003 and the related condensed consolidated statements of operations and cash flows for the three-month periods ended March 31, 2003 and 2002. 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.

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, 2002, 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 14, 2003 (March 6, 2003 as to Note 22)(which report includes an explanatory paragraph relating to the Company s change in its method of accounting for stock based compensation issued to employees as described in 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, 2002 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

April 28, 2003

Table of Contents**PREMCOR INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions, except share data)

	March 31, 2003	December 31, 2002
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 307.3	\$ 167.4
Short-term investments	4.9	4.9
Cash and cash equivalents restricted for debt service	53.8	61.7
Accounts receivable, net of allowance of \$3.3 and \$3.2	520.2	269.1
Inventories	463.4	287.3
Prepaid expenses	78.5	45.9
Assets held for sale	40.2	49.3
	<u>1,468.3</u>	<u>885.6</u>
Total current assets	1,468.3	885.6
PROPERTY, PLANT AND EQUIPMENT, NET	1,587.3	1,262.6
DEFERRED INCOME TAXES	40.8	57.5
OTHER ASSETS	124.6	117.3
	<u>\$ 3,221.0</u>	<u>\$ 2,323.0</u>
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 721.0	\$ 466.2
Accrued expenses and other	85.6	57.2
Accrued taxes other than income	41.9	26.3
Current portion of long-term debt	21.2	15.0
	<u>869.7</u>	<u>564.7</u>
Total current liabilities	869.7	564.7
LONG-TERM DEBT	1,154.5	909.9
OTHER LONG-TERM LIABILITIES	144.4	144.4
COMMITMENTS AND CONTINGENCIES		
COMMON STOCKHOLDERS EQUITY:		
Common, \$0.01 par value per share, 150,000,000 authorized, 74,085,860 issued and outstanding in 2003; 58,043,935 issued and outstanding in 2002	0.7	0.6
Paid-in capital	1,173.1	862.3
Accumulated deficit	(121.4)	(158.9)
	<u>1,052.4</u>	<u>704.0</u>
Total common stockholders equity	1,052.4	704.0
	<u>\$ 3,221.0</u>	<u>\$ 2,323.0</u>

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, in millions, except per share data)

	For the Three Months	
	Ended March 31,	
	2003	2002
		(as restated, see Note 1)
NET SALES AND OPERATING REVENUES	\$ 2,376.3	\$ 1,228.3
EXPENSES:		
Cost of sales	2,108.9	1,061.6
Operating expenses	117.2	114.5
General and administrative expenses	11.7	14.5
Stock-based compensation	4.3	1.9
Depreciation	14.6	12.4
Amortization	9.5	9.8
Refinery restructuring and other charges	15.0	142.0
	<u>2,281.2</u>	<u>1,356.7</u>
OPERATING INCOME (LOSS)	95.1	(128.4)
Interest and finance expense	(26.9)	(34.5)
Loss on extinguishment of long-term debt	(7.0)	
Interest income	1.6	3.5
	<u>62.8</u>	<u>(159.4)</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST	62.8	(159.4)
Income tax (provision) benefit	(21.0)	61.4
Minority interest		0.8
	<u>41.8</u>	<u>(97.2)</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS	41.8	(97.2)
Loss from discontinued operations, net of income tax benefit of \$2.7	(4.3)	
	<u>37.5</u>	<u>(97.2)</u>
NET INCOME (LOSS)	37.5	(97.2)
Preferred stock dividends		(2.5)
	<u>37.5</u>	<u>(99.7)</u>
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	\$ 37.5	\$ (99.7)
NET INCOME (LOSS) PER COMMON SHARE:		
Basic:		
Income (loss) from continuing operations	\$ 0.60	\$ (3.14)
Discontinued operations	(0.06)	
	<u>0.54</u>	<u>(3.14)</u>
Net income (loss)	\$ 0.54	\$ (3.14)

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Weighted average common shares outstanding	68.9	31.8
Diluted:		
Income (loss) from continuing operations	\$ 0.60	\$ (3.14)
Discontinued operations	(0.06)	
Net income (loss)	\$ 0.54	\$ (3.14)
Weighted average common shares outstanding	69.6	31.8

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, in millions)

	For the Three Months	
	Ended March 31,	
	2003	2002
		(as restated, see Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 37.5	\$ (97.2)
Adjustments:		
Loss on discontinued operations	7.0	
Depreciation	14.6	12.4
Amortization	12.0	12.4
Deferred income taxes	16.7	(61.7)
Stock-based compensation	4.3	1.9
Minority interest		(0.8)
Refinery restructuring and other charges	13.6	101.2
Write-off of deferred financing costs	4.7	
Other, net	2.6	8.8
Cash provided by (reinvested in) working capital		
Accounts receivable, prepaid expenses and other	(274.7)	(61.0)
Inventories	(10.8)	(13.8)
Accounts payable, accrued expenses, taxes other than income, and other	281.0	106.3
Cash and cash equivalents restricted for debt service	7.7	4.3
	116.2	12.8
Net cash provided by operating activities of continuing operations		
Net cash used in operating activities of discontinued operations	(0.3)	(1.5)
	115.9	11.3
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for property, plant and equipment	(22.0)	(14.8)
Expenditures for turnaround	(8.8)	(27.5)
Expenditures for refinery acquisition	(474.8)	
Cash and cash equivalents restricted for investment in capital additions	2.6	3.2
	(503.0)	(39.1)
Net cash used in investing activities		
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from the issuance of common stock, net	306.1	
Proceeds from the issuance of long-term debt	525.0	
Long-term debt and capital lease payments	(284.7)	(66.6)
Cash and cash equivalents restricted for debt repayment	0.2	(26.9)

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Deferred financing costs	<u>(19.6)</u>	<u>(1.1)</u>
Net cash provided by (used in) financing activities	<u>527.0</u>	<u>(94.6)</u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	<u>139.9</u>	<u>(122.4)</u>
CASH AND CASH EQUIVALENTS, beginning of period	<u>167.4</u>	<u>510.1</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 307.3</u>	<u>\$ 387.7</u>

The accompanying notes are an integral part of these financial statements.

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INDEPENDENT ACCOUNTANTS REPORT

To the Board of Directors of The Premcor Refining Group Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of The Premcor Refining Group Inc. and subsidiaries (the Company) as of March 31, 2003, and the related condensed consolidated statements of operations and cash flows for the three-month periods ended March 31, 2003 and 2002. 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.

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, 2002, and the related consolidated statements of operations, stockholder s equity, and cash flows for the year then ended (not presented herein). In our report dated February 14, 2003 (March 6, 2003 as to Note 20) (which report includes an explanatory paragraph relating to the Company s change in its method of accounting for stock based compensation issued to employees and the restatement of the consolidated financial statements to give effect to the contribution of Sabine River Holding Corp. common stock owned by Premcor Inc. (the Company s parent company) to the Company, which was accounted for in a manner similar to a pooling of interests as described in Notes 2 and 3), 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, 2002 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

April 28, 2003

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in millions, except share data)

	March 31, 2003	December 31, 2002
	(unaudited)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 255.8	\$ 119.7
Short-term investments	1.7	1.7
Cash and cash equivalents restricted for debt service	53.8	61.7
Accounts receivable, net of allowance of \$3.3 and \$3.2	520.0	269.0
Receivables from affiliates	26.4	13.1
Inventories	463.4	287.3
Prepaid expenses and other	77.9	45.7
Assets held for sale	40.2	49.3
	<u>1,439.2</u>	<u>847.5</u>
Total current assets	1,439.2	847.5
PROPERTY, PLANT AND EQUIPMENT, NET	1,560.9	1,261.7
DEFERRED INCOME TAXES	4.6	19.8
OTHER ASSETS	124.6	117.3
	<u>\$ 3,129.3</u>	<u>\$ 2,246.3</u>
LIABILITIES AND STOCKHOLDER S EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 720.4	\$ 466.2
Payables to affiliates	42.1	41.0
Accrued expenses and other	83.4	55.7
Accrued taxes other than income	41.9	26.4
Current portion of long-term debt	20.9	15.0
	<u>908.7</u>	<u>604.3</u>
Total current liabilities	908.7	604.3
LONG-TERM DEBT	1,144.3	869.8
OTHER LONG-TERM LIABILITIES	144.4	144.4
COMMITMENTS AND CONTINGENCIES		
COMMON STOCKHOLDER S EQUITY:		
Common, \$0.01 par value per share, 100 issued and outstanding		
Paid-in capital	806.7	541.4
Retained earnings	125.2	86.4
	<u>931.9</u>	<u>627.8</u>
Total common stockholder s equity	931.9	627.8
	<u>\$ 3,129.3</u>	<u>\$ 2,246.3</u>

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The accompanying notes are an integral part of these financial statements.

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THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in millions)

	For the Three Months	
	Ended March 31,	
	2003	2002
NET SALES AND OPERATING REVENUES	\$ 2,375.8	\$ 1,228.3
EXPENSES:		(as restated, see Note 1)
Cost of sales	2,109.6	1,062.0
Operating expenses	116.7	114.4
General and administrative expenses	11.7	14.4
Stock-based compensation	4.3	1.9
Depreciation	14.5	12.4
Amortization	9.5	9.8
Refinery restructuring and other charges	15.0	142.0
	<u>2,281.3</u>	<u>1,356.9</u>
OPERATING INCOME (LOSS)	94.5	(128.6)
Interest and finance expense	(26.2)	(30.5)
Loss on extinguishment of long-term debt	(4.7)	
Interest income	1.1	2.2
	<u>64.7</u>	<u>(156.9)</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST	64.7	(156.9)
Income tax (provision) benefit	(21.6)	60.6
Minority interest		0.8
	<u>43.1</u>	<u>(95.5)</u>
INCOME (LOSS) FROM CONTINUING OPERATIONS	43.1	(95.5)
Loss from discontinued operations, net of income tax benefit of \$2.7	(4.3)	
	<u>\$ 38.8</u>	<u>\$ (95.5)</u>
NET INCOME (LOSS)	\$ 38.8	\$ (95.5)

The accompanying notes are an integral part of these financial statements.

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THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in millions)

	For the Three Months	
	Ended March 31,	
	2003	2002
		(as restated, see Note 1)
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	\$ 38.8	\$ (95.5)
Adjustments:		
Loss on discontinued operations	7.0	
Depreciation	14.5	12.4
Amortization	12.0	12.4
Deferred income taxes	15.2	(60.9)
Stock-based compensation	4.3	1.9
Minority interest		(0.8)
Refinery restructuring and other charges	13.6	101.2
Write-off of deferred financing costs	4.7	
Other, net	2.5	8.6
Cash provided by (reinvested in) working capital		
Accounts receivable, prepaid expenses and other	(274.2)	(70.3)
Inventories	(10.8)	(13.8)
Accounts payable, accrued expenses, taxes other than income, and other	279.6	99.9
Affiliate receivables and payables	2.8	13.3
Cash and cash equivalents restricted for debt service	7.7	4.3
	117.7	12.7
Net cash provided by operating activities of continuing operations	117.7	12.7
Net cash used in operating activities of discontinued operations	(0.3)	(1.5)
	117.4	11.2
Net cash provided by operating activities	117.4	11.2
CASH FLOWS FROM INVESTING ACTIVITIES:		
Expenditures for property, plant and equipment	(22.0)	(14.8)
Expenditures for turnaround	(8.8)	(27.5)
Expenditures for refinery acquisition	(474.8)	
Cash and cash equivalents restricted for investment in capital additions	2.6	3.2
	(503.0)	(39.1)
Net cash used in investing activities	(503.0)	(39.1)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of long-term debt	525.0	
Long-term debt and capital lease payments	(244.5)	(66.6)
Capital contributions, net	260.6	

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Cash and cash equivalents restricted for debt repayment	0.2	(26.9)
Deferred financing costs	(19.6)	(1.1)
	<u> </u>	<u> </u>
Net cash provided by (used in) financing activities	521.7	(94.6)
	<u> </u>	<u> </u>
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	136.1	(122.5)
CASH AND CASH EQUIVALENTS, beginning of period	119.7	482.5
	<u> </u>	<u> </u>
CASH AND CASH EQUIVALENTS, end of period	\$ 255.8	\$ 360.0
	<u> </u>	<u> </u>

The accompanying notes are an integral part of these financial statements.

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FORM 10-Q PART I

ITEM 1. FINANCIAL STATEMENTS (continued)

PREMCOR INC. AND SUBSIDIARIES

THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

March 31, 2003

(Tabular amounts in millions, except per share data)

1. Nature of Business and Basis of Preparation

Premcor Inc., a Delaware corporation, was incorporated in April 1999. Premcor Inc. owns all of the outstanding common stock of Premcor USA Inc. (Premcor USA), a Delaware corporation formed in 1988. Premcor USA owns all of the outstanding common stock of The Premcor Refining Group Inc. (PRG), a Delaware corporation also formed in 1988. Premcor Inc. and its subsidiaries (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. As of March 31, 2003, the Company owned and operated three refineries with a combined crude oil throughput capacity of 610,000 barrels per day (bpd). The refineries are located in Port Arthur, Texas; Memphis, Tennessee; and Lima, Ohio.

All of the operations of the Company 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 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.

The accompanying unaudited condensed consolidated financial statements of Premcor Inc. and PRG and their respective 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 of normal recurring adjustments) necessary to fairly state the results for the interim periods presented. Operating results for the three months ended March 31, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. These combined consolidated notes apply equally to the Company and PRG and its subsidiaries, unless otherwise noted. These unaudited condensed financial statements should be read in conjunction with the audited financial statements and notes included in Premcor Inc.'s and PRG's combined Annual Report on Form 10-K for the year ended December 31, 2002.

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In the second quarter of 2002, the Company adopted the recognition and measurement provisions of Statement of Financial Accounting Standard (SFAS) No. 123, *Accounting for Stock-Based Compensation*, and effective January 1, 2002 recognized stock-based compensation expense using the fair value recognition provisions of SFAS No. 123 for all employee awards granted or modified after January 1, 2002. SFAS No. 123 requires the restatement

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of previously reported interim financial statements within the year of adoption, and accordingly, the Company restated the financial statements for the first quarter of 2002. For the three months ended March 31, 2002, the adoption of the fair value recognition provisions of SFAS No. 123 increased the Company's net loss available to common stockholders by \$0.2 million (\$0.01 per basic and diluted share) from amounts originally reported.

On June 6, 2002, Premcor Inc. and PRG completed a series of transactions, which resulted in Sabine River Holding Corp. and its subsidiaries (Sabine), becoming wholly owned subsidiaries of PRG. Prior to this date, Premcor Inc. held a 90% interest in Sabine and a subsidiary of Occidental Petroleum Corporation (Occidental) held a 10% interest. Sabine, through Port Arthur Coker Company L.P. (PACC), owns and operates a heavy oil processing facility, which is operated in conjunction with PRG's Port Arthur refinery. 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 in a manner similar to a pooling of interests. Accordingly, PRG's historical financial statements have been restated to include the consolidated financial position, results of operations, and cash flows of Sabine for all periods presented.

Certain reclassifications have been made to the prior year's financial statements to conform to classifications used in the current year.

2. New Accounting Standards

In July 2001, the Financial Accounting Standards Board (FASB) issued SFAS No. 143, *Accounting for Asset Retirement Obligations*. SFAS No. 143 requires fair value recognition of legal obligations to retire long-lived assets at the time the obligations are incurred. The initial recording of a liability for an asset retirement obligation will require the recording of a corresponding asset. The liability will be adjusted for accretion due to the passage of time and the asset will be depreciated. The Company has asset retirement obligations based on its legal obligations at its refinery sites. The Company considers the settlement date of the obligations indeterminable at this time due to uncertainty about the timing of the retirement of the long-lived assets. Accordingly, the Company cannot calculate an associated asset retirement liability at this time. The Company adopted this standard in the first quarter of 2003, but the initial adoption did not have a material impact on the Company's financial position or results of operations. The Company will measure and recognize the fair value of its asset retirement obligations at such time as a settlement date is determinable.

In November 2002, the FASB issued Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This interpretation requires expanded disclosure of a guarantor's obligation under certain guarantees that it has issued. It also requires that a guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing the guarantee. The disclosure requirements are effective for interim and annual financial statements issued for periods ending after December 15, 2002. The provisions for the recognition of a liability are effective prospectively for guarantees issued or modified after December 31, 2002. The Company has adopted the recognition provisions in the first quarter of 2003 with no material impact on its financial statements.

In January 2003, the FASB issued Interpretation No. 46, *Consolidation of Variable Interest Entities, an interpretation of ARB No. 51*. This interpretation clarifies consolidation requirements for variable interest entities. It establishes additional factors beyond ownership of a majority voting interest to indicate that a company has a controlling financial interest in an entity (or a relationship sufficiently similar to a controlling financial interest that it requires consolidation). This interpretation applies immediately to variable interest entities created or obtained after January 31, 2003 and must be retroactively applied to holdings in variable interest entities acquired before February 1, 2003 in interim and annual financial statements issued for periods beginning after June 15, 2003. The adoption of this interpretation did not have a material impact on the Company's financial statements.

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In April 2003, the agenda committee of the Emerging Issues Task Force (EITF) of the FASB placed the discussion of Issue No. 02-L, *Reporting Gains and Losses on Derivative Instruments That are Subject to SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and Not Held for Trading Purposes*, on the agenda for its May 14 15, 2003 meeting. It is anticipated the EITF will address Issue No. 02-L which deals with certain aspects of EITF 02-3, *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities*. EITF 02-3 currently requires that gains and losses on all derivative instruments within the scope of SFAS No. 133 be shown net in the income statement, whether or not settled physically, if the derivative instruments are held for trading purposes. The EITF is expected to address the income statement classification of gains and losses on energy contracts within the scope of SFAS No. 133 that are not held for trading purposes and the applicability of EITF 99-19 to such transactions. Energy contract arrangements that are settled physically qualify for gross reporting pursuant to EITF 99-19. Any consensus reached by the EITF on this issue may require changes in the Company's presentation of revenue and cost of sales. The Company does not expect that any such changes will have an impact on its gross margin.

Table of Contents**3. Memphis Refinery Acquisition and Related Financing Transactions**

Effective March 3, 2003, the Company completed the acquisition of the Memphis, Tennessee refinery and related supply and distribution assets from The Williams Companies, Inc. and certain of its subsidiaries (Williams) at a purchase price of \$310 million plus approximately \$159 million for crude and product inventories, which is subject to finalization, and approximately \$6 million in transaction fees. 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. The transfer of certain of these assets remains subject to obtaining certain third party consents. No portion of the purchase price was held back relative to this delayed transfer, and the Company is able to utilize the assets based on interim agreements.

The acquisition of the Memphis refinery and related supply and distribution assets was accounted for using the purchase method, and the results of operations of these assets have been included in the Company's first quarter results from the date of acquisition. The preliminary purchase price allocation, which is subject to change pending finalization of the crude and product inventory settlement with Williams, completion of independent appraisals, and completion of other evaluations including the assessment of any asset retirement obligations, is as follows:

Current assets	\$ 174.3
Property, plant, and equipment	321.9
Accrued liabilities (including current portion of long-term debt)	(11.2)
Long-term debt (capital leases)	(10.2)
	<u>\$ 474.8</u>

As part of the purchase agreement, the Company assumed liabilities of \$11.2 million that primarily related to cancellation fees for contracts entered into by Williams for Tier II technology that will not be utilized by the Company and environmental remediation of a recently closed land farm. Williams assigned several leases to the Company including two capitalized leases that relate to the leasing of crude oil and product pipelines that are within the Memphis refinery system connecting the refinery to storage facilities and other third party pipelines. Both capital leases have 15-year terms with approximately 14 years of the term remaining.

The purchase agreement also provides for contingent participation, or earn-out, payments up to a maximum aggregate of \$75 million to Williams over the next seven years, depending on the level of industry refining margins during that period. The earn-out payments will be calculated annually at the end of the seven 12-month periods beginning on March 3, 2003. The annual earn-out calculation will be equal to one-half of the excess of the actual daily value of the Gulf Coast 2/1/1 crack spread over a stipulated margin, at a crude oil throughput rate of 167,123 bpd. The stipulated margin is \$3.25 per barrel for the first year and increases by \$0.10 per barrel for each year thereafter. Any amounts the Company pays to Williams as a result of the earn-out agreement will be recorded as additional refinery purchase price on the calculation date, and depreciated or amortized accordingly.

Related Financing Transactions

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PRG acquired the refinery and related assets utilizing a portion of the proceeds from the issuance of \$525 million in senior notes and utilizing capital contributions from Premcor Inc., which were funded from the proceeds of a public and private offering of common stock.

On January 30, 2003, Premcor Inc. completed a public offering of 12.5 million shares of common stock and a private placement of 2.9 million shares of common stock with Blackstone Capital Partners III Merchant Banking Fund L.P. and its affiliates (Blackstone), Occidental, and certain Premcor executives. On February 5, 2003, Premcor Inc. sold an additional 0.6 million shares of common stock pursuant to the underwriters over-allotment option. Premcor Inc. received net proceeds of approximately \$306 million from these transactions. On February 11, 2003, PRG completed an offering of \$525 million in senior notes, of which \$350 million, due in 2013, bear interest at 9½% per annum and \$175 million, due in 2010, bear interest at 9¼% per annum. Concurrently, PRG amended and restated its credit agreement as described in Note 7, Credit Agreement.

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In addition to the refinery acquisition, the proceeds from these transactions were also used to redeem the remaining \$40.1 million principal balance of Premcor USA's 11½% subordinated debentures plus a premium thereon of \$2.3 million and to repay PRG's \$240 million floating rate loan at par.

Loss on Extinguishment of Long-term Debt

As a result of the early extinguishment of long-term debt and credit agreement restructuring, the Company recorded a loss of \$7.0 million (PRG \$4.7 million) in the first quarter of 2003. For PRG, the loss included a write-off of unamortized deferred financing costs of \$4.7 million related to the repayment of the floating rate loan and the amendment of PRG's credit agreement. In addition to the \$4.7 million write-off, the Company recorded a loss of \$2.3 million for a premium related to the redemption of Premcor USA's 11½% subordinated debentures.

4. Refinery Restructuring and Other Charges

In September 2002, the Company ceased refining operations at its Hartford, Illinois refinery and as of December 31, 2002, had written down the long-lived refining assets to their estimated net realizable value of \$49.0 million in anticipation of a sale or lease of the refining assets. The Company continued to operate the storage and distribution facility at the refinery site. In the first quarter of 2003, the Company signed a memorandum of understanding with ConocoPhillips for a sale of refining assets and certain storage and distribution assets for \$40 million. In the first quarter of 2003, the Company recorded refinery restructuring and other charges of \$16.6 million related to the transaction, which included the write-down of the refining assets held for sale and certain storage and distribution assets included in property, plant and equipment.

In the first quarter of 2002, the Company recorded refinery restructuring and other charges of \$142.0 million, which consisted of a \$131.2 million charge related to the then planned shutdown of refining operations at the Hartford, Illinois refinery, a \$15.8 million charge related to the restructuring of management and administrative functions; and income of \$5.0 million related to the unanticipated sale of a portion of the Blue Island refinery assets previously written off.

As of December 31, 2002, the Company had a \$4.9 million reserve for plans announced in the third quarter of 2002 to reduce additional staff at the St. Louis administrative office in early 2003. As a result of the Memphis refinery acquisition, the number of positions to be eliminated has been reduced by 25 and the Company recorded a reduction in the restructuring reserve of \$1.6 million in the first quarter of 2003. The Company expects to complete the restructuring of its St. Louis administrative functions by the end of the year. The Company also had a \$1.0 million reserve for employee severance and plant closure/equipment remediation related to shutdown of the refining operations at the Hartford refinery. The activities related to the Hartford closure were completed in the first quarter of 2003. The following schedule summarizes the activity and balance of these restructuring reserves as of March 31, 2003:

	Reserve as of December 31, 2002	Adjustment to Reserve	Net Cash Outlay	Reserve as of March 31, 2003
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
St. Louis restructuring	\$ 4.9	\$ (1.6)	\$ (1.5)	\$ 1.8
Hartford closure:				
Employee severance	0.6		(0.6)	

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Plant closure/equipment remediation	<u>0.4</u>	<u></u>	<u>(0.4)</u>	<u></u>
	\$ 5.9	\$ (1.6)	\$ (2.5)	\$ 1.8

Table of Contents**5. Inventories**

The carrying value of inventories consisted of the following:

	March 31, 2003	December 31, 2002
Crude oil	\$ 151.4	\$ 63.8
Refined products and blendstocks	286.5	204.5
Warehouse stock and other	25.5	19.0
	\$ 463.4	\$ 287.3

The market value of crude oil, refined products and blendstock inventories at March 31, 2003 was approximately \$159 million (December 31, 2002 \$188 million) above carrying value.

6. Other Assets

Other assets consisted of the following:

	March 31, 2003	December 31, 2002
Deferred turnaround costs	\$ 85.6	\$ 86.3
Deferred financing costs	36.8	24.2
Cash restricted for investment in capital additions		2.6
Other	2.2	4.2
	\$ 124.6	\$ 117.3

Amortization of deferred financing costs for the three months ended March 31, 2003 was \$2.3 million for both the Company and PRG (2002 the Company \$2.5 million, PRG \$2.4 million), and was included in Interest and finance expense. In the first quarter of 2003, the Company incurred deferred financing costs of \$19.6 million related to the amendment of its credit agreement and the issuance of \$525 million in senior notes. In the first quarter of 2003, the Company wrote-off \$4.7 million of unamortized deferred financing costs as a result of the early repayment of portions of its long-term debt and the amendment of its credit agreement.

7. Credit Agreement

PRG's credit agreement, which was amended and restated in February 2003, provides for letter of credit issuances of up to the lesser of \$750 million or an amount available under a defined borrowing base, less outstanding borrowings. The facility may be increased to \$800 million under certain circumstances. PRG utilizes this facility primarily for the issuance of letters of credit to secure crude oil purchase obligations. The borrowing base includes PRG's unrestricted cash and eligible cash equivalents, eligible investments, eligible receivables, eligible petroleum inventories, paid but unexpired letters of credit, net obligations on swap contracts and PACC's eligible hydrocarbon inventory. The credit agreement expires in February 2006. As of March 31, 2003, the borrowing base was \$1,090.8 million (December 31, 2002 \$815.3 million), with \$575.0 million (December 31, 2002 \$597.1 million) of the facility utilized for letters of credit.

The credit agreement provides for direct cash borrowings of up to, but not exceeding in the aggregate, \$200 million, subject to sublimits of \$75 million for working capital and general corporate purposes and \$150 million for acquisition-related working capital. Acquisition-related borrowings are subject to a defined repayment provision. Borrowings under the credit agreement are secured by a lien on substantially all of PRG's unrestricted cash and cash equivalents, receivables, crude oil and refined product inventories and trademarks and PACC's hydrocarbon inventory. PRG's interest rate for any borrowings under this agreement would bear interest at a rate based on either the U.S. prime lending rate or the Eurodollar rate plus a defined margin, at PRG's option, based on certain

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restrictions. As of March 31, 2003 and December 31, 2002, there were no direct cash borrowings under the credit agreement.

The credit agreement contains covenants and conditions that, among other things, limit PRG's dividends, indebtedness, liens, investments and contingent obligations. PRG is also required to comply with certain financial covenants, including the maintenance of minimum working capital of \$150 million and the maintenance of minimum tangible net worth of \$650 million. The covenants also provide for a cumulative cash flow test that from January 1, 2003 must not be less than zero.

8. Long-term Debt

Significant transactions affecting long-term debt were discussed in Note 3. Long-term debt consisted of the following:

	<u>March 31,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
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⁾)	99.7	99.7
8 ⁷ / ₈ % Senior Subordinated Notes due November 15, 2007		
(8 ⁷ / ₈ % Senior Subordinated Notes ⁽¹⁾)	174.4	174.4
Floating Rate Term Loan due November 15, 2003 and 2004		
(Floating Rate Loan ⁽¹⁾)		240.0
12 ¹ / ₂ % Senior Notes due January 15, 2009		
(12 ¹ / ₂ % Senior Notes ⁽²⁾)	246.3	250.7
9 ¹ / ₄ % Senior Notes due February 01, 2010		
(9 ¹ / ₄ % Senior Notes ⁽¹⁾)	175.0	
9 ¹ / ₂ % Senior Notes due February 01, 2013		
(9 ¹ / ₂ % Senior Notes ⁽¹⁾)	350.0	
11 ¹ / ₂ % Subordinated Debentures due October 1, 2009		
(11 ¹ / ₂ % Subordinated Debenture ⁽³⁾)		40.1
Ohio Water Development Authority Environmental Facilities Revenue Bonds due December 01, 2031	10.0	10.0
Obligation under capital leases ⁽⁴⁾	10.5	0.2
	<u>1,175.7</u>	<u>924.9</u>
Less current portion	<u>21.2</u>	<u>15.0</u>

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Total long-term debt at Premcor Inc.	\$ 1,154.5	\$ 909.9
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- (1) Issued or borrowed by PRG
 - (2) Issued or borrowed by PAFC
 - (3) Issued or borrowed by Premcor USA
 - (4) Assumed by The Premcor Pipeline Co., a subsidiary of Premcor USA

PRG's long-term debt, including current maturities, as of March 31, 2003 was \$1,165.2 million and is the same as the Premcor Inc. long-term debt as noted in the table above except that it excludes the \$10.5 million of capital lease obligations. The Premcor Pipeline Co. assumed these lease obligations as part of the Memphis acquisition. PRG's long-term debt, including current maturities, as of December 31, 2002 was \$884.8 million and is the same as the Premcor Inc. long-term debt as noted in the table above except that it excludes the \$40.1 million in 11½% Subordinated Debentures issued by Premcor USA.

Table of Contents**9. Stock-based Compensation Expense**

As of March 31, 2003, the Company had outstanding stock awards accounted for under the intrinsic value method of APB Opinion No. 25, *Accounting for Stock Issued to Employee* (awards granted prior to January 1, 2002). The following table illustrates the effect on net income and earnings per share if the fair value based method of SFAS No. 123 had been applied to all outstanding awards in each period as opposed to only the awards granted or modified after January 1, 2002.

	For the Three Months Ended March 31,	
	2003	2002
Net income (loss), as reported	\$ 37.5	\$ (99.7)
Add: Stock-based compensation expense included in reported net income, net of tax effect	2.7	4.8
Deduct: Stock-based compensation expense determined under fair value based method for all options, net of tax effect	(2.7)	(4.9)
Pro forma net income (loss)	\$ 37.5	\$ (99.8)
Earnings per share:		
Basic as reported and pro forma	\$ 0.54	\$ (3.14)
Diluted as reported and pro forma	0.54	(3.14)

10. Interest and Finance Expense

Interest and finance expense included in the statements of operations consisted of the following:

	Premcor Inc.		PRG	
	For the Three Months Ended March 31,		For the Three Months Ended March 31,	
	2003	2002	2003	2002
Interest expense	\$ 26.8	\$ 32.1	\$ 26.1	\$ 28.2
Financing costs	2.4	4.2	2.4	4.1
Capitalized interest	(2.3)	(1.8)	(2.3)	(1.8)
	\$ 26.9	\$ 34.5	\$ 26.2	\$ 30.5

The Company's cash paid for interest expense for the three months ended March 31, 2003 was \$25.1 million (2002 \$37.9 million). PRG's cash paid for interest expense for the three months ended March 31, 2003 was \$23.1 million (2002 \$37.9 million).

11. Income Taxes

The Company made no net cash income tax payments nor received any net cash income tax refunds during the first quarter of 2003 (2002 received net cash income tax refunds of \$11.7 million). PRG made no net cash income tax payments nor received any net cash income tax refunds during the first quarter of 2003 (2002 no income tax payment or refunds). The \$11.7 million refund in the first quarter of 2002 was received by Premcor Inc. This refund related to a 2001 estimated income tax payment made primarily on behalf of Sabine and was due to Sabine under the terms of its tax sharing agreement with Premcor Inc. and a common security agreement related to PACC senior debt. The refund was returned to Sabine by Premcor Inc. in the second quarter of 2002.

12. Discontinued Operations

In connection with the 1999 sale of the Company's retail assets to Clark Retail Enterprises, Inc. (CRE), 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 these leases, including payment of rent and taxes. PRG may also

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be contingently liable for environmental cleanup responsibilities for releases of petroleum occurring during the term of the CRE 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. As CRE rejects some or all of these leases from its reorganization plan, PRG may become responsible for these obligations. In bankruptcy hearings held in the first quarter of 2003, CRE rejected 30 of these leases. The Company recorded an after-tax charge of \$4.3 million in the first quarter of 2003 representing the estimated net present value of our remaining liability under these rejected leases, net of estimated sub-lease income. The Company is currently in discussions with CRE regarding their reorganization plans, the status of environmental remediation agreements, and other matters. While it is possible that the Company may incur additional liability for CRE lease obligations or other costs as CRE finalizes its reorganization plans, the amounts are not estimable at this time.

13. Earnings per Share

The common stock shares used to compute the Company's basic and diluted earnings per share was as follows:

	For the Three Months Ended March 31,	
	2003	2002
Weighted average common shares outstanding	68.9	31.8
Dilutive effect of:		
Stock options	0.7	
Common stock warrants		
Weighted average common shares outstanding, assuming dilution	69.6	31.8

Stock options of 4.4 million shares for the three months ended March 31, 2003, were excluded from the diluted earnings per share calculation because they were anti-dilutive. Stock options and warrants representing common stock equivalents of 3.5 million shares were excluded from diluted shares outstanding for the three months ended March 31, 2002 due to their anti-dilutive effect as a result of the Company's net loss.

Table of Contents**14. Consolidating Financial Statements of PRG as Co-guarantor of PAFC's Senior Notes**

Presented below are the PRG consolidating balance sheets, statement of operations, and cash flows as required by Rule 3-10 of the Securities Exchange Act of 1934. PRG along with PACC, Sabine, and various other subsidiaries of Sabine are full and unconditional guarantors of Port Arthur Finance Corp's (PAFC) 12½% Senior Notes. PAFC is a wholly owned subsidiary of PACC. Under Rule 3-10, the consolidating balance sheets, statement of operations, and cash flows presented below meet the requirements for financial statements of the issuer and each guarantor of the notes since the issuer and guarantors are all direct or indirect wholly owned subsidiaries of PRG, and all guarantees are full and unconditional and joint and several.

THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES**CONSOLIDATING BALANCE SHEET**

As of March 31, 2003

(unaudited, in millions)

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated PRG</u>
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	\$ 250.8	\$	\$ 5.0	\$	\$ 255.8
Short-term investments	1.7				1.7
Cash and cash equivalents restricted for debt service			53.8		53.8
Accounts receivable	517.6		2.4		520.0
Receivable from affiliates	71.4	27.4	139.5	(211.9)	26.4
Inventories	431.7		31.7		463.4
Prepaid expenses and other	76.9		1.0		77.9
Assets held for sale	40.2				40.2
	<u>1,390.3</u>	<u>27.4</u>	<u>233.4</u>	<u>(211.9)</u>	<u>1,439.2</u>
Total current assets					
PROPERTY, PLANT AND EQUIPMENT, NET	955.9		605.0		1,560.9
DEFERRED INCOME TAXES	56.5			(51.9)	4.6
INVESTMENT IN AFFILIATE	393.2			(393.2)	
OTHER ASSETS	109.6		15.0		124.6
NOTE RECEIVABLE FROM AFFILIATE		225.4		(225.4)	
	<u>\$ 2,905.5</u>	<u>\$ 252.8</u>	<u>\$ 853.4</u>	<u>\$ (882.4)</u>	<u>\$ 3,129.3</u>
LIABILITIES AND STOCKHOLDER'S EQUITY					
CURRENT LIABILITIES:					
Accounts payable	\$ 619.0	\$	\$ 101.4	\$	\$ 720.4
Payable to affiliates	175.3		55.4	(188.6)	42.1
Accrued expenses and other	76.4	6.5	0.5		83.4
Accrued taxes other than income	40.1		1.8		41.9
Current portion of long-term debt		20.9			20.9

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Current portion of notes payable to affiliate			23.3	(23.3)	
Total current liabilities	910.8	27.4	182.4	(211.9)	908.7
LONG-TERM DEBT	918.9	225.4			1,144.3
DEFERRED INCOME TAXES			51.9	(51.9)	
OTHER LONG-TERM LIABILITIES	143.9		0.5		144.4
NOTE PAYABLE TO AFFILIATE			225.4	(225.4)	
COMMON STOCKHOLDER S EQUITY:					
Common stock			0.1	(0.1)	
Paid-in capital	806.7		206.0	(206.0)	806.7
Retained earnings	125.2		187.1	(187.1)	125.2
Total common stockholder s equity	931.9		393.2	(393.2)	931.9
	\$ 2,905.5	\$ 252.8	\$ 853.4	\$ (882.4)	\$ 3,129.3

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONSOLIDATING STATEMENT OF OPERATIONS****For the three months ended March 31, 2003****(unaudited, in millions)**

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated PRG</u>
NET SALES AND OPERATING REVENUES	\$ 2,513.8	\$	\$ 704.3	\$ (842.3)	\$ 2,375.8
EQUITY IN EARNINGS OF AFFILIATE	62.3			(62.3)	
EXPENSES:					
Cost of sales	2,392.7		550.9	(834.0)	2,109.6
Operating expenses	82.4		42.6	(8.3)	116.7
General and administrative expenses	10.7		1.0		11.7
Stock-based compensation	4.3				4.3
Depreciation	9.1		5.4		14.5
Amortization	9.5				9.5
Refinery restructuring and other charges	15.0				15.0
	<u>2,523.7</u>		<u>599.9</u>	<u>(842.3)</u>	<u>2,281.3</u>
OPERATING INCOME	52.4		104.4	(62.3)	94.5
Interest and finance expense	(17.5)	(7.7)	(8.7)	7.7	(26.2)
Loss on extinguishment of long-term debt	(4.7)				(4.7)
Interest income	1.0	7.7	0.1	(7.7)	1.1
	<u>INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES</u>		<u>95.8</u>	<u>(62.3)</u>	<u>64.7</u>
Income tax (provision) benefit	11.9		(33.5)		(21.6)
	<u>INCOME FROM CONTINUING OPERATIONS</u>		<u>62.3</u>	<u>(62.3)</u>	<u>43.1</u>
Loss from discontinued operations, net of income tax benefit of \$2.7	(4.3)				(4.3)
	<u>NET INCOME</u>	<u>\$ 38.8</u>	<u>\$ 62.3</u>	<u>\$ (62.3)</u>	<u>\$ 38.8</u>

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONSOLIDATING STATEMENT OF CASH FLOWS****For the three months ended March 31, 2003****(unaudited, in millions)**

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated PRG</u>
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income	\$ 38.8	\$	\$ 62.3	\$ (62.3)	\$ 38.8
Adjustments:					
Loss on discontinued operations	7.0				7.0
Depreciation	9.1		5.4		14.5
Amortization	11.1		0.9		12.0
Deferred income taxes	10.5		4.7		15.2
Stock-based compensation	4.3				4.3
Refinery restructuring and other charges	13.6				13.6
Write-off of deferred financing costs	4.7				4.7
Equity in earnings of affiliate	(62.3)			62.3	
Other, net	2.3		0.2		2.5
Cash provided by (reinvested in) working capital:					
Accounts receivable, prepaid expenses and other	(273.1)		(1.1)		(274.2)
Inventories	(6.7)		(4.1)		(10.8)
Accounts payable, accrued expenses, taxes other than income, and other	312.9	(7.9)	(25.4)		279.6
Affiliate receivables and payables	36.4	12.2	(45.8)		2.8
Cash and cash equivalents restricted for debt service			7.7		7.7
	<u>108.6</u>	<u>4.3</u>	<u>4.8</u>		<u>117.7</u>
Net cash provided by operating activities of continuing operations	108.6	4.3	4.8		117.7
Net cash used in operating activities of discontinued operations	(0.3)				(0.3)
	<u>108.3</u>	<u>4.3</u>	<u>4.8</u>		<u>117.4</u>
Net cash provided by operating activities	108.3	4.3	4.8		117.4
CASH FLOWS FROM INVESTING ACTIVITIES:					
Expenditures for property, plant and equipment	(22.0)				(22.0)
Expenditures for turnaround	(8.8)				(8.8)
Expenditures for refinery acquisition	(474.8)				(474.8)
Cash and cash equivalents restricted for investment in capital additions	2.6				2.6
	<u>(503.0)</u>				<u>(503.0)</u>
Net cash used in investing activities	(503.0)				(503.0)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Proceeds from issuance of long-term debt	525.0				525.0
Long-term debt and capital lease payments	(240.2)	(4.3)			(244.5)
Capital contributions, net	260.6				260.6
Cash and cash equivalents restricted for debt repayment			0.2		0.2
Deferred financing costs	(19.6)				(19.6)

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Net cash provided by (used in) financing activities	525.8	(4.3)	0.2	521.7
NET INCREASE IN CASH AND CASH EQUIVALENTS	131.1		5.0	136.1
CASH AND CASH EQUIVALENTS, Beginning of period	119.7			119.7
CASH AND CASH EQUIVALENTS, end of period	\$ 250.8	\$	\$ 5.0	\$ 255.8

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONSOLIDATING BALANCE SHEET**

As of December 31, 2002

(in millions)

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations</u>	<u>Consolidated PRG</u>
ASSETS					
CURRENT ASSETS:					
Cash and cash equivalents	\$ 119.7	\$	\$	\$	\$ 119.7
Short-term investments	1.7				1.7
Cash and cash equivalents restricted for debt service			61.7		61.7
Accounts receivable	268.7		0.3		269.0
Receivable from affiliates	32.9	29.2	50.7	(99.7)	13.1
Inventories	259.7		27.6		287.3
Prepaid expenses and other	43.7		2.0		45.7
Assets held for sale	49.3				49.3
	<u>775.7</u>	<u>29.2</u>	<u>142.3</u>	<u>(99.7)</u>	<u>847.5</u>
Total current assets	775.7	29.2	142.3	(99.7)	847.5
PROPERTY, PLANT AND EQUIPMENT, NET	651.3		610.4		1,261.7
DEFERRED INCOME TAXES	67.0			(47.2)	19.8
INVESTMENT IN AFFILIATE	330.9			(330.9)	
OTHER ASSETS	101.4		15.9		117.3
NOTE RECEIVABLE FROM AFFILIATE	2.3	235.9		(238.2)	
	<u>\$ 1,928.6</u>	<u>\$ 265.1</u>	<u>\$ 768.6</u>	<u>\$ (716.0)</u>	<u>\$ 2,246.3</u>
LIABILITIES AND STOCKHOLDER S EQUITY					
CURRENT LIABILITIES:					
Accounts payable	\$ 342.9	\$	\$ 123.3	\$	\$ 466.2
Payable to affiliates	117.7		20.1	(96.8)	41.0
Accrued expenses and other	40.9	14.4	0.4		55.7
Accrued taxes other than income	21.1		5.3		26.4
Current portion of long-term debt	0.2	14.8			15.0
Current portion of notes payable to affiliate			2.9	(2.9)	
	<u>522.8</u>	<u>29.2</u>	<u>152.0</u>	<u>(99.7)</u>	<u>604.3</u>
Total current liabilities	522.8	29.2	152.0	(99.7)	604.3
LONG-TERM DEBT	633.9	235.9			869.8
DEFERRED INCOME TAXES			47.2	(47.2)	
OTHER LONG-TERM LIABILITIES	144.1		0.3		144.4
NOTE PAYABLE TO AFFILIATE			238.2	(238.2)	
COMMITMENTS AND CONTINGENCIES					
COMMON STOCKHOLDER S EQUITY:					
Common stock			0.1	(0.1)	
Paid-in capital	541.4		206.0	(206.0)	541.4
Retained earnings	86.4		124.8	(124.8)	86.4

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Total common stockholder's equity	627.8		330.9	(330.9)	627.8
	<u>627.8</u>	<u> </u>	<u>330.9</u>	<u>(330.9)</u>	<u>627.8</u>
	\$ 1,928.6	\$ 265.1	\$ 768.6	\$ (716.0)	\$ 2,246.3
	<u>\$ 1,928.6</u>	<u>\$ 265.1</u>	<u>\$ 768.6</u>	<u>\$ (716.0)</u>	<u>\$ 2,246.3</u>

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONSOLIDATING STATEMENT OF OPERATIONS****For the three months ended March 31, 2002****(unaudited, in millions)**

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations and Minority Interest</u>	<u>Consolidated PRG</u>
NET SALES AND OPERATING REVENUES	\$ 1,255.9	\$	\$ 420.7	\$ (448.3)	\$ 1,228.3
EQUITY IN EARNINGS OF AFFILIATE	(7.3)			7.3	
EXPENSES:					
Cost of sales	1,123.1		379.6	(440.7)	1,062.0
Operating expenses	88.3		33.7	(7.6)	114.4
General and administrative expenses	13.3		1.1		14.4
Stock-based compensation	1.9				1.9
Depreciation	7.2		5.2		12.4
Amortization	9.8				9.8
Refinery restructuring and other charges	142.0				142.0
	<u>1,385.6</u>		<u>419.6</u>	<u>(448.3)</u>	<u>1,356.9</u>
OPERATING INCOME (LOSS)	(137.0)		1.1	7.3	(128.6)
Interest and finance expense	(16.0)	(12.0)	(14.6)	12.1	(30.5)
Interest income	1.4	12.0	0.9	(12.1)	2.2
	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>
LOSS BEFORE INCOME TAXES AND MINORITY INTEREST	(151.6)		(12.6)	7.3	(156.9)
Income tax benefit	56.1		4.5		60.6
Minority interest				0.8	0.8
	<u></u>	<u></u>	<u></u>	<u></u>	<u></u>
NET LOSS	\$ (95.5)	\$	\$ (8.1)	\$ 8.1	\$ (95.5)

Table of Contents**THE PREMCOR REFINING GROUP INC. AND SUBSIDIARIES****CONSOLIDATING STATEMENT OF CASH FLOWS**

For the three months ended March 31, 2002

(unaudited, in millions)

	<u>PRG</u>	<u>PAFC</u>	<u>Other Guarantor Subsidiaries</u>	<u>Eliminations And Minority Interest</u>	<u>Consolidated PRG</u>
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net loss	\$ (95.5)	\$	\$ (8.1)	\$ 8.1	\$ (95.5)
Adjustments:					
Depreciation	7.2		5.2		12.4
Amortization	11.6		0.8		12.4
Deferred income taxes	(56.3)		(4.6)		(60.9)
Stock-based compensation	1.9				1.9
Minority interest				(0.8)	(0.8)
Refinery restructuring and other charges	101.2				101.2
Equity in earnings of affiliate	7.3			(7.3)	
Other, net	8.4		0.2		8.6
Cash provided by (reinvested in) working capital:					
Accounts receivable, prepaid expenses and other	(73.0)		2.7		(70.3)
Inventories	(38.1)		24.3		(13.8)
Accounts payable, accrued expenses, taxes other than income, and other	64.6	(9.5)	44.8		99.9
Affiliate receivables and payables	49.1	75.7	(111.5)		13.3
Cash and cash equivalents restricted for debt service			4.3		4.3
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) operating activities of continued operations	(11.6)	66.2	(41.9)		12.7
Net cash used in operating activities of discontinued operations	(1.5)				(1.5)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash provided by (used in) operating activities	(13.1)	66.2	(41.9)		11.2
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
CASH FLOWS FROM INVESTING ACTIVITIES:					
Expenditures for property, plant and equipment	(14.4)		(0.4)		(14.8)
Expenditures for turnaround	(27.5)				(27.5)
Cash and cash equivalents restricted for investment in capital additions	3.2				3.2
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash used in investing activities	(38.7)		(0.4)		(39.1)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
CASH FLOWS FROM FINANCING ACTIVITIES:					
Long-term debt and capital lease payments	(0.4)	(66.2)			(66.6)
Cash and cash equivalents restricted for debt repayment			(26.9)		(26.9)
Deferred financing costs			(1.1)		(1.1)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Net cash used in financing activities	(0.4)	(66.2)	(28.0)		(94.6)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(52.2)		(70.3)		(122.5)

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CASH AND CASH EQUIVALENTS, beginning of period	<u>259.7</u>	<u> </u>	<u>222.8</u>	<u> </u>	<u>482.5</u>
CASH AND CASH EQUIVALENTS, end of period	<u>\$ 207.5</u>	<u>\$</u>	<u>\$ 152.5</u>	<u>\$</u>	<u>\$ 360.0</u>

Table of Contents**15. Commitments and Contingencies***Environmental, Discontinued Operations and Legal Reserves*

As a result of its normal course of business, the Company is a party to a number of legal proceedings and environmental-related obligations. The Company has also incurred liabilities related to leases of previously operated retail sites as discussed in Note 12, Discontinued Operations. In relation to these matters and obligations the Company has accrued, on an undiscounted basis unless otherwise noted, the following:

	March 31, 2003	December 31, 2002
Refinery environmental obligations:		
Hartford	\$ 29.8	\$ 29.6
Blue Island	19.2	19.7
Port Arthur	11.8	11.9
Memphis	1.0	
Discontinued retail marketing:		
Environmental obligations	23.2	23.0
Lease obligations (discounted)	6.8	
Other legal and environmental	8.4	9.0
	<u>\$ 100.2</u>	<u>\$ 93.2</u>

The Company is of the opinion that the ultimate resolution of these claims and obligations, 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 and MACT II

The Environmental Protection Agency, or EPA, has promulgated 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. The Company expects to incur in the aggregate approximately \$727 million, including \$657 million that it expects to expend through 2006, in order to comply with environmental regulations related to the new stringent sulfur content specifications and MACT II regulations. Future revisions to these current cost estimates may be necessary as the Company continues to finalize its plans. Information related to the expected expenditures in relation to these new regulations is shown below.

Total Estimated Expenditures	Total Expenditures Incurred	Remaining Expenditures	Contract Commitments	Year of Concentration of Expenditures
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		To-Date	at March 31, 2003		
Gasoline Low sulfur standards	\$ 335	\$ 66	\$ 269	\$ 126	2003/2004
Diesel low sulfur standards	347	4	343		2005
MACT II	45		45		2003/2004
Total	\$ 727	\$ 70	\$ 657	\$ 126	

Other Commitments

Crude Oil Purchase Commitment. On October 1, 2002, the Company entered into a crude oil linefill agreement with Morgan Stanley Capital Group Inc. (MSCG), which obligated it to purchase 2.7 million barrels of crude oil in the pipeline system supplying the Lima refinery from MSCG. The Company will purchase the 2.7 million barrels of crude oil upon termination of the agreement with MSCG, 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.

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Long-Term Crude Oil Agreement. PACC has a long-term crude oil supply agreement with PMI Comercio Internacional, S.A. de C.V., an affiliate of Petroleos Mexicanos or PEMEX, the Mexican state oil company, which supplies approximately 162,000 barrels per day of Maya crude oil to the Port Arthur refinery. Under the terms of this agreement, PACC is obligated to buy Maya crude oil from the affiliate of PEMEX, and the affiliate of PEMEX is obligated to sell Maya crude oil to PACC. The agreement also provides a price adjustment mechanism designed to minimize the effect of adverse refining margin cycles and more specifically 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 cumulative difference, calculated on a monthly basis, between the actual coker gross margin and the defined minimum coker margin is referred to as a surplus or shortfall, and as of March 31, 2003, a cumulative quarterly surplus of \$137.7 million existed under the agreement. As a result, the price the Company pays for Maya crude oil purchased under this agreement in succeeding quarters will not be discounted until this cumulative surplus is offset by future shortfalls.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Certain statements in this document are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These statements are subject to the safe harbor provisions of this legislation. Words such as expects, intends, plans, projects, believes, estimates, will and similar expressions typically identify such forward-looking statements.

Even though we believe our expectations regarding future events are based on reasonable assumptions, forward-looking statements are not guarantees of future performance. Important factors that could cause actual results to differ materially from those contained in our forward-looking statements include, among others, changes in:

Industry-wide refining margins;

Crude oil and other raw material costs, the cost of transportation of crude oil, embargoes, industry expenditures for the discovery and production of crude oil, military conflicts between, or internal instability in, one or more oil-producing countries, governmental actions, and other disruptions of our ability to obtain crude oil;

Market volatility due to world and regional events;

Availability and cost of debt and equity financing;

Labor relations;

U.S. and world economic conditions;

Supply and demand for refined petroleum products;

Reliability and efficiency of our operating facilities which are affected by such potential hazards as equipment malfunctions, plant construction/repair delays, explosions, fires, oil spills and the impact of severe weather and other factors which could result in significant unplanned downtime;

Actions taken by competitors which may include product pricing strategies, production decisions, and expansion or retirement of refinery capacity;

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Civil, criminal, regulatory or administrative actions, claims or proceedings and regulations dealing with protection of the environment, including refined petroleum product composition and characteristics;

Acts of war or terrorism;

Other unpredictable or unknown factors not discussed.

Because of all of these uncertainties, and others, you should not place undue reliance on our forward-looking statements.

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Overview

This Management Discussion and Analysis of Financial Condition and Results of Operations reflects the results of operations and financial condition of Premcor Inc. and subsidiaries, which are materially the same as the results of operations and financial condition of PRG. Therefore, the discussions provided are equally applicable to Premcor Inc. and PRG except where otherwise noted.

We are an independent petroleum refiner and supplier of unbranded transportation fuels, heating oil, petrochemical feedstocks, petroleum coke and other petroleum products in the United States. We own and operate three refineries with a combined crude oil throughput capacity of approximately 610,000 barrels per day, or bpd. Our refineries are located in Port Arthur, Texas; Memphis, Tennessee; and Lima, Ohio. We acquired our Memphis refinery in March 2003. We sell petroleum products in the Midwest, the Gulf Coast and the Eastern and Southeastern United States on an unbranded basis to approximately 1,200 distributors and chain retailers through a combination of our own product distribution system and an extensive third-party owned product distribution system, as well as in the spot market.

Major Developments

Effective March 3, 2003, we completed the acquisition of the Memphis, Tennessee refinery and related supply and distribution assets from The Williams Companies, Inc. and certain of its subsidiaries (Williams) at a purchase price of \$310 million plus approximately \$159 million for crude and product inventories, and approximately \$6 million in transaction fees. 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. The transfer to us of certain of these assets remains subject to third party consents. No portion of the purchase price was held back relative to this delayed transfer, and we are able to utilize these assets based on interim agreements.

The acquisition of the Memphis refinery and related supply and distribution assets was accounted for using the purchase method, and the results of operations of these assets have been included in our first quarter results from the date of acquisition. The preliminary purchase price allocation, which is subject to change pending finalization of the crude and product inventory settlement with Williams, completion of independent appraisals, and completion of other evaluations including the assessment of any asset retirement obligations, is as follows (in millions):

Current assets	\$ 174.3
Property, plant, and equipment	321.9
Accrued liabilities (including current portion of long-term debt)	(11.2)
Long-term debt (capital leases)	(10.2)
	<u>474.8</u>
	<u>\$ 474.8</u>

As part of the purchase agreement, we assumed liabilities of \$11.2 million that primarily related to cancellation fees for contracts entered into by Williams for Tier II technology that will not be utilized by us and environmental remediation of a recently closed land farm. Williams assigned several leases to us including two capitalized leases that relate to the leasing of crude oil and product pipelines that are within the Memphis

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refinery system connecting the refinery to storage facilities and other third party pipelines. Both capital leases have 15-year terms with approximately 14 years of the term remaining.

The purchase agreement also provides for contingent participation, or earn-out, payments up to a maximum aggregate of \$75 million to Williams over the next seven years, depending on the level of industry refining margins during that period. The earn-out payments will be calculated annually at the end of the seven 12-month periods beginning on March 3, 2003. The annual earn-out calculation will be equal to one-half of the excess of the actual daily value of the Gulf Coast 2/1/1 crack spread over a stipulated margin, at a crude oil throughput rate of 167,123 bpd. The stipulated margin is \$3.25 per barrel for the first year and increases by \$0.10 per barrel for each year thereafter. Any amounts we pay to Williams as a result of the earn-out agreement will be recorded as additional refinery purchase price on the calculation date, and depreciated or amortized accordingly.

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PRG acquired the refinery and related assets utilizing a portion of the proceeds from the issuance of \$525 million in senior notes and utilizing capital contributions from Premcor Inc., which were funded from the proceeds of a public and private offering of common stock. PRG also amended and restated its credit agreement to allow for the acquisition. See Liquidity and Capital Resources Cash Flows from Financing Activities for additional details of the financings.

Table of Contents**Results of Operations**

The following tables reflect Premcor Inc.'s financial and operating highlights for the three months ended March 31, 2003 and 2002.

Financial Results

	Three Months	
	Ended March 31,	
	2003	2002
	(in millions, except per share data)	
Net sales and operating revenues	\$ 2,376.3	\$ 1,228.3
Cost of sales	2,108.9	1,061.6
Gross margin	267.4	166.7
Operating expenses	117.2	114.5
General and administrative expenses	11.7	14.5
Stock-based compensation expense	4.3	1.9
Depreciation and amortization	24.1	22.2
Refinery restructuring and other charges	15.0	142.0
Operating income (loss)	95.1	(128.4)
Interest expense and finance income, net	(25.3)	(31.0)
Loss on extinguishment of long-term debt	(7.0)	
Income tax benefit (provision)	(21.0)	61.4
Minority interest		0.8
Income (loss) from continuing operations	41.8	(97.2)
Discontinued operations	(4.3)	
Net income (loss)	37.5	