





MANAGEMENT'S DISCUSSION AND ANALYSIS

THE FOLLOWING DISCUSSION AND ANALYSIS SHOULD BE READ IN CONJUNCTION WITH THE COMPANY'S AUDITED FINANCIAL STATEMENTS AND THE ACCOMPANYING NOTES. PART OF THE FINANCIAL INFORMATION PRESENTED IN THIS SECTION IS DERIVED FROM THE COMPANY'S AUDITED FINANCIAL STATEMENTS THAT HAVE BEEN PREPARED IN ACCORDANCE WITH INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS").

1 CONSOLIDATED RESULTS OF OPERATIONS

In 2006, the Company's turnover, other operating revenues and other income were RMB 1,076.4 billion, and the operating profit was RMB 83.8 billion, representing an increase of 29.3% and 22.8%, respectively, over those in the previous year. These

increases were largely attributable to the following factors: by seizing the opportunities presented by the high market prices of petroleum and chemical products and steady growth of the domestic economy, the Company strived to implement the resource strategy, proactively expand the

market share, optimised refining and petrochemical production, made great efforts on safety, resource conservation, reduction of utilities consumption and cost, all of which contributed to the comparatively good operating results achieved in 2006.

The following table sets forth the major items in the consolidated income statement of the Company for the indicated periods.

	Years Ended 31 December		Rate of Change (%)
	2006	2005	
	(RMB in millions)		
Turnover, other operating revenues and other income	1,076,402	832,687	29.3
Of which: Turnover	1,044,652	799,259	30.7
Other operating revenues	26,750	24,013	11.4
Other income	5,000	9,415	(46.9)
Operating expenses	(992,582)	(764,441)	29.8
Of which: Purchased crude oil, products, and operating supplies and expenses	(861,437)	(651,201)	32.3
Selling, general and administrative expenses	(37,758)	(33,880)	11.4
Depreciation, depletion and amortisation	(34,235)	(31,618)	8.3
Exploration expenses (including dry holes)	(7,983)	(6,411)	24.5
Personnel expenses	(19,857)	(18,649)	6.5
Employee reduction expenses	(236)	(369)	(36.0)
Taxes other than income tax	(28,639)	(17,185)	66.7
Other operating expenses, net	(2,437)	(5,128)	(52.5)
Operating profit	83,820	68,246	22.8
Net finance costs	(6,100)	(4,625)	31.9
Investment income and share of profit less losses from associates	1,203	1,035	16.2
Profit before tax	78,923	64,656	22.1
Taxation	(23,515)	(19,880)	18.3
Profit for the year	55,408	44,776	23.7
Attributable to:			
Equity shareholders of the Company	53,912	41,455	30.0
Minority interests	1,496	3,321	(55.0)

(1) Turnover, Other Operating Revenues and Other Income

In 2006, the Company's turnover, other operating revenues and other income were RMB 1,076.4 billion, of which, the turnover was RMB 1,044.7 billion, representing an increase of 30.7% over 2005. These increases were mainly attributable to the Company's efforts in expanding resources and markets as well as optimising its sales

and marketing structure in order to take advantage of the high international prices of crude oil, petroleum and chemical products.

In 2006, the Company's other operating revenues was RMB 26.8 billion, representing an increase of 11.4% over 2005. Other operation revenue included: income from service fee, sales of materials, sales of utilities, etc.

At the end of 2006, the Company received from the PRC government a one-off compensation of RMB 5 billion.

The following table sets forth the Company's external sales volume, average realised prices and the respective rate of changes from 2005 to 2006 for the Company's major products.

	Sales Volume (thousand tonnes)			Average realised prices (RMB per tonne)		
	2006	2005	Rate of change (%)	2006	2005	Rate of change (%)
Crude oil	5,079	5,289	(4.0)	3,218	2,680	20.1
Natural gas (million cubic meters, RMB per thousand cubic meters)	5,366	4,356	23.2	789	673	17.2
Gasoline	32,589	30,191	7.9	5,225	4,432	17.9
Diesel	72,934	67,247	8.5	4,469	3,772	18.5
Kerosene	5,427	6,003	(9.6)	4,524	3,710	21.9
Basic chemical feedstock	10,862	8,658	25.5	5,762	4,846	18.9
Monomers and polymers for synthetic fiber	3,775	2,993	26.1	8,846	8,879	(0.4)
Synthetic resin	7,775	6,343	22.6	9,921	9,005	10.2
Synthetic fiber	1,613	1,585	1.8	11,389	11,123	2.4
Synthetic rubber	800	678	18.0	13,928	13,040	6.8
Chemical fertiliser	1,651	1,822	(9.4)	1,650	1,539	7.2

Note: The above crude oil and natural gas sold externally were self-produced

Most of the crude oil and a small portion of the natural gas produced by the Company were internally used for refining and chemicals production, the remaining was sold to the refineries of Sinopec Group Company and other customers. In 2006, the turnover for crude oil, natural gas and other products that were sold externally amounted to RMB 23.4 billion, representing an increase of 17.6% over 2005, accounting for 2.2% of the Company's total turnover, other operating revenues and other income. The increase was mainly due to the increase in crude oil prices and the Company's expansion of its natural gas business.

The Company's refining segment and marketing and distribution segment sell petroleum products (mainly consisting of gasoline, diesel, kerosene including jet fuel (refined oil products) and other refined

petroleum products) to third parties. In 2006, the external sales revenue of petroleum products by these two segments were RMB 687.5 billion, representing an increase of 26.8% over 2005, accounting for 63.9% of the Company's turnover, other operating revenues and other income. The increase was mainly due to the Company's proactive efforts in taking advantage of the high price of petroleum products through increasing sales volume, optimising sales and marketing structure and expanding the market of other refined petroleum products. The sales revenues of gasoline, diesel and kerosene were RMB 520.8 billion, representing an increase of 27.1% over 2005, and accounting for 75.8% of the total sales revenues of petroleum products. The sales revenues of other refined petroleum products were RMB 166.7 billion, representing an increase of 25.9% over

2005, accounting for 24.2% of the total sales revenues of petroleum products.

The Company's external sales revenues of chemical products were RMB 209.1 billion, representing an increase of 30.0% over 2005, accounting for 19.4% of the Company's total turnover, other operating revenues and other income. The increase was mainly due to the Company's effort to capture the opportunity presented by the high price of chemical products by increasing its production & sales volume.

(2) Operating expenses

In 2006, the Company's operating expenses amounted to RMB 992.6 billion, representing an increase of 29.8% over 2005. The operating expenses mainly consisted of:

Purchased crude oil, products and operating supplies and expenses were RMB 861.4 billion, representing an increase of 32.3% over 2005, the throughput of the Company's crude oil purchased externally was 114.31 million tonnes (excluding the amounts processed for third parties), representing an increase of 5.9% over 2005; the average cost for crude oil purchased externally was RMB3,750 /tonne (approximately US\$ 64.09/barrel), representing an increase of 19.7% over 2005; the Company's other purchase expenses were RMB 432.7 billion, representing an increase of 37.4% over 2005, accounting for 43.6% of the total operating expenses. The increase was mainly due to the increased costs of refined oil products and chemical feedstock purchased externally.

Selling, general and administrative expenses totaled RMB 37.8 billion, representing an increase of 11.4% over 2005. The increase was largely due to: an increase of RMB 1.25 billion in repairing and maintenance expenses as a result of the renovation and maintenance work carried out in 2006 on service stations; an increase of RMB 610 million in operating lease expenses as a result of the increased land rental expenses; an increase of RMB 650 million in service fee paid to support functions due to the increased number of service stations; an increase of RMB 400 million in mineral resources compensatory fee as a result of increased sales revenue of crude oil and natural gas.

Depreciation, depletion and amortisation were RMB 34.2 billion, representing an increased of 8.3% over 2005. This was mainly due to the additions of fixed assets invested by the Company in recent two years.

Exploration expenses were RMB 8 billion, representing an increase of 24.5% over 2005, mainly due to the Company's increased exploration efforts in the Southern marine facies blocks and new areas in west China in 2006.

Personnel expenses were RMB 19.9 billion, representing an increase of 6.5% over 2005.

Employee reduction expenses were approximately RMB 240 million.

Taxes other than income tax were RMB 28.6 billion, representing an increase of 66.7% over 2005. The increase was largely due to the special oil income levy amounting to RMB 8.75 billion which has been introduced by the PRC government since 26 March 2006. In addition, the consumption tax increased by RMB 1.69 billion mainly due to the increased sales volume of gasoline and diesel and the national policy of expanding tax scope of consumption tax.

Other operating expenses were RMB 2.4 billion, representing a decrease of 52.5% over 2005. The decrease was largely due to the decrease of RMB 450 million in losses on disposal of fixed assets, decrease of RMB 1.03 billion in impairment losses on long-lived assets over 2005, and a debt extinguishment income of RMB 490 million from one of the Company's subsidiaries.

(3) Operating profit

In 2006, the Company's operating profit was RMB 83.8 billion, representing an increase of 22.8% over 2005.

(4) Net finance costs

In 2006, the Company's net finance costs were RMB 6.1 billion, representing an

increase of 31.9% over 2005. The increase was mainly due to an increase of RMB 1.5 billion in net interest expenses as a result of the increase in the loan balance and the increased interest rates.

(5) Profit before tax

In 2006, the Company's profit before tax was RMB 78.9 billion, representing an increase of 22.1% over 2005.

(6) Taxation

In 2006, the Company's taxation was RMB 23.5 billion, representing an increase of 18.3% over 2005.

(7) Profit attributable to minority interests

In 2006, the Company's profit attributable to minority interests was RMB 1.5 billion, representing a decrease of 55.0% over 2005. The decrease was mainly due to the Company's privatisation of certain of its listed subsidiaries and thereby reduced minority shareholdings in these subsidiaries.

(8) Profit attributable to equity shareholders of the Company

In 2006, the Company's profit attributable to equity shareholders of the Company was RMB 53.9 billion, representing an increase of 30.0% over 2005.

2 DISCUSSIONS ON RESULTS OF SEGMENT OPERATIONS

The Company divides its operations into four business segments (exploration and production segment, refining segment, marketing and distribution segment and chemicals segment) and corporate and

others. Unless otherwise specified, the inter-segment transactions have not been eliminated in the financial data discussed in this section. In addition, the operating revenue data of each segment have included the "other operating revenues" and "other income" of the segment.

The following table sets forth the operating revenue by each segment, the contribution of external sales and inter-segment sales as a percentage of operating revenue before elimination of inter-segment sales, and the contribution of external sales as a percentage of consolidated operating revenues (i.e. after elimination of inter-segment sales) for the periods indicated.

	Operating Revenues		As a Percentage of Consolidated Operating Revenues Before Elimination of Inter-segment Sales		As a Percentage of Consolidated Operating Revenues, After Elimination of Inter-segment Sales	
	Years Ended 31 December		Operating Revenues		Operating Revenues,	
	2006	2005	2006	2005	2006	2005
	RMB millions		(%)		(%)	
Exploration and Production Segment						
External sales ⁽¹⁾	37,510	30,762	2.1	2.3	3.5	3.7
Inter-segment sales	105,656	84,423	5.8	6.2		
Operating revenues	143,166	115,185	7.9	8.5		
Refining Segment						
External sales ⁽¹⁾	108,791	97,646	6.0	7.2	10.1	11.7
Inter-segment sales	471,571	386,456	26.1	28.3		
Operating revenues	580,362	484,102	32.1	35.5		
Marketing and Distribution Segment						
External sales ⁽¹⁾	588,957	460,650	32.6	33.8	54.7	55.3
Inter-segment sales	4,601	3,172	0.3	0.2		
Operating revenues	593,558	463,822	32.9	34.0		
Chemicals Segment						
External sales ⁽¹⁾	215,794	166,624	11.9	12.2	20.0	20.0
Inter-segment sales	12,299	12,199	0.7	0.9		
Operating revenues	228,093	178,823	12.6	13.1		
Corporate and others						
External sales ⁽¹⁾	125,350	77,005	6.9	5.6	11.7	9.3
Inter-segment sales	136,775	44,897	7.6	3.3		
Operating revenues	262,125	121,902	14.5	8.9		
Operating revenues before elimination of inter-segment sales	1,807,304	1,363,834	100.0	100.0		
Elimination of inter-segment sales	(730,902)	(531,147)				
Consolidated operating revenues	1,076,402	832,687			100.0	100.0

Note: (1) include other operating revenues and other income.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following table sets forth the operating revenues, operating expenses and operating profit/loss by each segment before elimination of the inter-segment transactions for the periods indicated, and the rate of changes from 2005 to 2006.

	Years Ended 31 December		Rate of Change (%)
	2006 (RMB millions)	2005 (RMB millions)	
Exploration and Production Segment			
Operating revenues	143,166	115,185	24.3
Operating expenses	79,984	66,851	19.6
Operating profit	63,182	48,334	30.7
Refining Segment			
Operating revenues	580,362	484,102	19.9
Operating expenses	605,660	487,638	24.2
Operating loss	(25,298)	(3,536)	615.4
Marketing and Distribution Segment			
Operating revenues	593,558	463,822	28.0
Operating expenses	563,324	453,472	24.2
Operating profit	30,234	10,350	192.1
Chemicals Segment			
Operating revenues	228,093	178,823	27.6
Operating expenses	210,859	164,527	28.2
Operating profit	17,234	14,296	20.6
Corporate and others			
Operating revenues	262,125	121,902	115.0
Operating expenses	263,657	123,100	114.2
Operating loss	(1,532)	(1,198)	27.9

(1) Exploration and production segment

Most of the crude oil and a small portion of the natural gas produced by the exploration and production segment were used for the Company's refining and chemicals production. Most of the natural gas and a small portion of crude oil produced were sold to refineries owned by Sinopec Group Company and other customers.

In 2006, the operating revenues of this segment were RMB 143.2 billion, representing an increase of 24.3% over 2005, largely due to the increases in the sales price and volume of crude oil and natural gas compared with those in 2005.

In 2006, this segment sold 37.94 million tonnes of crude oil and 5.7 billion cubic meters of natural gas, representing an increase of 2.9% and 28.4% respectively compared with those in 2005. The average realised price of crude oil was RMB 3,195 per tonne (approximately US\$ 56.53 per barrel), representing an increase of 19.9% over 2005. The average realised price of natural gas was RMB 794 per thousand cubic meters, representing an increase of 18.0% over 2005.

In 2006, the operating expenses of this segment were RMB 80 billion, representing an increase of 19.6% over 2005. The increase was mainly due to:

- The increase of approximately RMB 9.4 billion in the taxes other than income tax was largely due to the special oil income levy imposed by the PRC government and the mineral resources compensation fees associated with the increased sales revenue of crude oil.
- The increase of approximately RMB 1.6 billion in exploration expenses including dry holes cost was mainly due to the increased exploration efforts by the Company in marine facies blocks in the south of China and newly developed areas in the west China.
- The increase of RMB 1.8 billion in depreciation, depletion and amortisation was resulted from the continuous investment in fixed assets.

In 2006, in light of the high crude oil price, in order to increase its oil and gas production, the Company developed marginal oil reserves, which, together with

increased water and electricity charges associated with oil and gas production, contributed to the increase in the lifting cost of crude oil and natural gas by 6.6% from RMB 488/tonne (US\$ 8.41 per barrel) in 2005 to RMB 520/tonne (US\$ 9.21 per barrel) in 2006.

In 2006, this segment's operating profit was RMB 63.2 billion, representing an increase of 30.7% over 2005.

(2) Refining segment

The business activities of the refining segment consist of purchasing crude oil from the exploration and production segment and third parties, processing crude oil into petroleum products, selling gasoline, diesel and kerosene to marketing and distribution segment, selling a portion of chemical feedstock to chemicals segment and selling other refined petroleum products to domestic and foreign customers.

In 2006, this segment's operating revenues were approximately RMB 580.4 billion, representing an increase of 19.9% over 2005. The increase was mainly due to the increased sales price and sales volume of various refined petroleum products.

The following table sets forth the sales volume, average realised price and the respective rate of changes of major refined petroleum products of the segment in 2005 and 2006.

	Sales Volume (thousand tonnes)			Average Realised Prices (RMB per tonne)		
	2006	2005	Rate of Change (%)	2006	2005	Rate of Change (%)
Gasoline	21,861	21,520	1.6	4,492	3,763	19.4
Diesel	57,578	54,128	6.4	3,859	3,462	11.5
Chemical feedstock	26,545	26,446	0.4	4,523	3,734	21.1
Other refined petroleum products	37,015	32,724	13.1	3,521	3,121	12.8

In 2006, the sales revenues of gasoline by the segment were RMB 98.2 billion, representing an increase of 21.2% over 2005, accounting for 16.9% of this segment's operating revenue. The sales revenues of diesel by the segment were RMB 222.2 billion, representing an increase of 18.6% over 2005, accounting for 38.3% of this segment's operating revenue. The sales revenue of chemical feedstock by the segment were RMB 120.1 billion, representing an increase of 21.6% over 2005, accounting for 20.7% of this segment's operating revenue. The sales revenues of refined petroleum products other than gasoline, diesel and chemical feedstock were RMB 130.3 billion, representing an increase of 27.6% over 2005, accounting for 22.5% of this segment's operating revenues.

In 2006, the operating expenses of the segment were RMB 605.7 billion, representing an increase of 24.2% over 2005. The increase was mainly due to the increase in crude oil price and refinery throughput. Among which, the average crude oil cost was RMB 3,674 per tonne (approximately US\$ 62.79 per barrel), representing an increase of 19.9% over 2005; Refinery throughput was 143.55 million tonnes (excluding the volume processed for third parties) in 2006, representing an increase of 5.5% over 2005. The total crude oil costs in 2006 were RMB 527.4 billion, representing an increase of 26.5% over 2005, accounting for 87.1% of the total operating expenses of the segment, up by 1.6 percentage points over 2005.

In 2006, although the international crude oil price remained at a high level with volatility, the PRC government implemented tight

control over domestic price of refined oil products, as a result, the Company's refining segment incurred significant loss, despite that the Company strive to reduce the crude oil cost by increasing the processing volume of lower quality crude oil as well as expanding the market of other refined petroleum products, increasing the sales volume of refined petroleum products with high added value. The refining margin was only RMB-20/tonne (approximately US\$-0.34/barrel) (sales revenue less costs of crude oil, refining feedstock costs and taxes other than income tax, divided by throughput of crude oil and refining feedstock), representing a decrease of RMB 99/tonne (approximately US\$ 1.66/barrel) as compared with RMB 79/tonne (approximately US\$1.32/barrel) in 2005.

In 2006, the refining cash operating cost (defined as operating expenses less the purchase costs of crude oil and refining feedstock, depreciation and amortisation, taxes other than income tax, other business expenses and adjustments; and divided by the throughput of crude oil and refining feedstock) was RMB 135/tonne (US\$ 2.31 per barrel), representing an increase of RMB 20/tonne (US\$ 0.40 per barrel), or 17.4%, over 2005. This change was mainly due to the increase of equipment maintenance expenses caused by increased processing volume of lower quality crude oil, and increased fuel purchased externally to substitute the fuel for internal use, and the increase of part of variable cost for product structural optimisation.

In 2006, this segment incurred an operating loss of RMB 25.3 billion, representing an increase in loss of RMB 21.8 billion over 2005.

(3) Marketing and distribution segment

The business activities of marketing and distribution segment include purchasing refined oil products from the refining segment and third parties, and wholesale of refined oil products to domestic customers, direct sale and retail of the refined oil products through the retail network owned by this segment and provision of related services.

In 2006, the operating revenues of this segment were RMB 593.6 billion, representing an increase of 28.0% over 2005. The increase was mainly due to the continuous optimisation of marketing structure to further increase the percentage of retail sales in the total sales volume of gasoline and diesel and the increase in sales volume and prices of gasoline, diesel and kerosene including jet fuel,

In 2006, the operating revenue from sales of gasoline and diesel were RMB 500.1 billion, accounting for 84.3% of the operating revenue of this segment. The percentage of retail in the total sales volume of gasoline and diesel increased from 59.6% in 2005 to 63.4% in 2006, up by 3.8 percentage points. The percentage of sales of gasoline and diesel by direct sales as a percentage of the total sales volume decreased from 19.1% in 2005 to 17.0% in 2006, down by 2.1 percentage points. The percentage of wholesale sales as a percentage of the total sales volume of gasoline and diesel decreased from 21.3% in 2005 to 19.6% in 2006, down by 1.7 percentage points.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

The following table sets forth the sales volume, average realised prices and the respective rate of changes of the four major product categories in 2005 and 2006 in different forms of sales channels for gasoline and diesel.

	Sales Volume (thousand tonnes)			Average Realised Prices (RMB per tonne)		
	2006	2005	Rate of Change (%)	2006	2005	Rate of Change (%)
Gasoline	32,718	30,319	7.9	5,224	4,430	17.9
Of which: Retail	23,885	21,629	10.4	5,350	4,562	17.3
Direct sales	2,812	2,839	(1.0)	4,922	4,206	17.0
Wholesale	6,021	5,851	2.9	4,867	4,050	20.2
Diesel	73,694	67,925	8.5	4,466	3,767	18.6
Of which: Retail	43,528	36,896	18.0	4,527	3,885	16.5
Direct sales	15,309	15,909	(3.8)	4,599	3,786	21.5
Wholesale	14,856	15,120	(1.7)	4,152	3,458	20.1
Kerosene	5,397	5,955	(9.4)	4,524	3,710	21.9
Fuel oil	15,067	13,334	13.0	2,989	2,374	25.9

In 2006, the segment's operating expenses were RMB 563.3 billion, representing an increase of 24.2% over 2005. The increase was mainly due to the increase in purchase expenses, of which, the purchase expenses for gasoline and diesel were RMB 443.8 billion, up by 24.8% over 2005, accounting for 78.8% of the segment's operating expenses.

In 2006, purchase prices of gasoline and diesel increased by 19.0% and 13.5%, respectively, to RMB 4,573 per tonne and RMB 3,992 per tonne compared with 2005. The purchase volume of gasoline and diesel increased, up to 32.72 million tonnes and 73.69 million tonnes by 7.9% and 8.5%, respectively, over 2005.

In 2006, the segment's unit cash selling expenses (defined as the operating expenses less the purchase costs, taxes other than income tax, depreciation and amortisation,

and divided by the sales volume) was RMB 167 per tonne, representing an increase by 2.7% over 2005. This increase was primarily due to the increase of retail volume and maintenance expenses caused by improving image of service stations.

In 2006, the segment's operating profit was RMB 30.2 billion, representing an increase of RMB 19.9 billion over 2005. The increase was primarily due to the continuous optimisation of marketing structure to further increase the percentage of retail in total sales volume of gasoline and diesel and the increases in sales volume and prices of refined oil products.

(4) Chemicals Segment

The business activities of the chemicals segment include purchasing chemical feedstock from the refining segment and third parties, and producing, marketing and distribution of petrochemical products.

In 2006, the segment's operating revenues were RMB 228.1 billion, representing an increase of 27.6% over 2005, which was primarily due to the increases in the price and sales volume of major chemical products.

In 2006, the sales revenue of the Company's six major categories of chemical products (i.e. basic organic chemicals, monomers and polymers for synthetic fiber, synthetic resin, synthetic fiber, synthetic rubber and chemical fertiliser) totaled approximately RMB 215.7 billion, representing an increase of 35.2% over 2005, accounting for 94.6% of the total operating revenues of this segment.

The following table sets forth the sales volume, average realised price and the respective rate of changes for each of these six categories of chemical products of this segment from 2005 to 2006.

	Sales Volume (thousand tonnes)			Average Realised Prices (RMB/Tonne)		
	2006	2005	Rate of Change (%)	2006	2005	Rate of Change (%)
Basic organic chemicals	12,749	9,509	34.1	5,609	4,828	16.2
Monomers and polymers for synthetic fiber	3,801	3,003	26.6	8,839	8,872	(0.4)
Synthetic resin	7,892	6,366	24.0	9,870	9,007	9.6
Synthetic fiber	1,614	1,585	1.8	11,390	11,123	2.4
Synthetic rubber	833	703	18.5	13,885	13,000	6.8
Chemical fertiliser	1,654	1,824	(9.3)	1,660	1,539	7.9

In 2006, the operating expenses of the segment were RMB 210.9 billion, representing an increase of 28.2% over 2005. The increase was primarily due to increase in the price of feedstock, as well as the increased consumption of various raw materials and utilities, and the increase in other variable and fixed costs, associated with the increased production of the chemical products.

Of which:

- The costs of raw materials increased by RMB 44.9 billion over 2005, as a result of the increase in the consumption of raw materials and their unit prices.
- Fuel and power costs increased by RMB 1.7 billion over 2005, as a result of the increased production volume of chemical products.

In 2006, the segment's operating profit was RMB 17.2 billion, representing an increase of 20.6% over 2005.

(5) Corporate and others

The business activities of corporate and others mainly consist of the import and export businesses of the subsidiaries, research and development activities of the Company and administrative activities of its headquarters.

In 2006, the operating revenues of corporate and others from import and export businesses were RMB 260.4 billion and the operating expenses were RMB 259.4 billion. The operating profit from import and export businesses was RMB 1.0 billion.

In 2006, the expenses in research and development activities of the Company and administrative activities of its headquarters were RMB 2.5 billion.

The segment's operating losses were RMB 1.5 billion, representing an increase in loss of RMB 300 million over 2005.

3 ASSETS, LIABILITIES, EQUITY AND CASH FLOWS

The Company's primary sources of funding were from operating activities, short-term and long-term borrowings, and primary uses of funds were for operating expenses, capital expenditures and repayments for short-term and long-term borrowings.

(1) Assets, liabilities and equity

Unit: RMB in millions

	At 31 December		Amount Changes
	2006	2005	
Total assets	611,790	549,040	62,750
Current assets	145,467	147,057	(1,590)
Non-current assets	466,323	401,983	64,340
Total liabilities	327,001	294,060	32,941
Current liabilities	210,802	175,011	35,791
Non-current liabilities	116,199	119,049	(2,850)
Equity attributable to equity shareholders of the Company	262,845	224,301	38,544
Share capital	86,702	86,702	—
Reserves	176,143	137,599	38,544
Minority interests	21,944	30,679	(8,735)
Total equity	284,789	254,980	29,809

The Company's total assets were RMB 611.8 billion, representing an increase of RMB 62.8 billion over 2005, of which:

- The current assets was 145.5 billion, decreased by RMB 1.6 billion over 2005. The decrease was mainly due to the centralised management on bank deposit implemented by the Company since the beginning of 2006 and reduced cash position, which resulted in a decrease of RMB 6.3 billion in cash and cash equivalents and time deposit at financial institutions; prepaid expenses and other current assets decreased by RMB 1.7 billion, which was mainly due to the decrease of prepayment for construction projects and equipment purchases; the increase of RMB 3.9 billion in the Company's

inventory was the result of the increased throughput; the increase of RMB 2.5 billion in bills receivable and accounts receivable was in line with the significant increase in the Company's turnover.

- The non-current assets was RMB 466.3 billion increased by RMB 64.3 billion over 2005. The increase was mainly due to the net increase of RMB 49.1 billion in property, plant and equipment which was in line with the investment plan and the increase of goodwill by RMB 11.6 billion as a result of the privatisation of its subsidiaries.

The total liabilities were RMB 327.0 billion, representing an increase of RMB 32.9 billion over 2005, of which:

- The current liabilities increased by RMB 35.8 billion over 2005 to RMB 210.8 billion. The increase was mainly due to the increase of RMB 15.5 billion in short-term borrowings caused by the increase of production and sale volume; the increase of RMB 19.5 billion in accrued expenses and other

accounts payable which was mainly due to the increase in receipts in advance from customers, accrued expenditures and amounts payable to Sinopec Group Company and its subsidiaries.

- The non-current liabilities decreased by RMB 2.9 billion over 2005 to RMB 116.2 billion, primarily due to

the decrease of the Company's long-term borrowings.

The equity attributable to the Company's shareholders were RMB 262.8 billion, representing an increase of RMB 38.5 billion over 2005, due to the increase of reserves.

(2) Cash flow

The following table sets forth the major items on the consolidated cash flow statements in 2005 and 2006

Major items of cash flows

Unit: RMB in millions

	Years Ended 31 December	
	2006	2005
Net cash flow from operating activities	95,875	78,214
Net cash flow from investing activities	(103,023)	(77,523)
Net cash flow from financing activities	1,192	(4,851)
Net decrease in cash and cash equivalents	(5,956)	(4,160)

In 2006, profit before taxation was RMB 78.9 billion; after adjusting the non-cash expenses items, the adjusted cash flow from operating activities was RMB 124.6 billion. Major non-cash expense items included: depreciation, depletion and amortisation of RMB 34.2 billion, interest expenses of RMB 7.4 billion, dry holes costs of RMB 4.0 billion, losses from disposal of properties, plant and equipment of RMB 1.6 billion.

The changes in operation-related accounts receivable and payable items reduced cash inflow of RMB 700 million, which was mainly due to the Company's expanded production and operation resulting in increased capital employed.

After adjusting the non-cash expense items and accounts receivable and payable items with regard to the profit before taxation, and deducting the cash outflow for payment of income tax totaling RMB 20.3 billion, and the net cash outflow of RMB 8.9 billion for net interests paid as well as the dividend received totaling RMB 1.2 billion, the net cash flow from operating activities was RMB 95.9 billion.

Net cash outflow for investing activities was RMB 103.0 billion. The net cash flow for investing activities mainly represented cash outflows of RMB 78.6 billion for capital expenditures and exploratory wells

expenses, cash outflows of RMB 3.6 billion for purchase of investments and interests in associated companies and subsidiaries, and RMB 22.0 billion for acquisition of minority interests in subsidiaries.

Net cash inflow for financing activities was RMB 1.2 billion, mainly due to increased bank loans.

During 2006, the Company captured the opportunity of robust market demand to steadily increase cash flow from operating activities. At the same time, the Company increased the investment, strived to expand the resources and the markets, developed various financing channels and tightened its control over the scale and risk of debt to guarantee the supply of capital.

(3) Contingent liabilities

Refer to the descriptions under Major Guarantees and Performance in Significant Events of this annual report.

(4) Capital expenditure

Refer to the descriptions under Capital Expenditure in Business Review and Prospects of this annual report.

(5) Research and development expenses and environmental expenses

Research and development expenses refer to the expenses that have been recognised

during the period in which they incurred. In 2006, the Company's research and development expenses were RMB 2.9 billion.

Environmental expenses refer to the normal routine effluent processing fees paid by the Company, excluding any capitalised costs for effluent processing facilities. In 2006, the Company's environmental expenses were RMB 1.6 billion.

(6) Analysis of financial statements prepared under the PRC Accounting Rules and Regulations

The major differences between the Company's financial statements prepared under the PRC Accounting Rules and Regulations and IFRS are set out in Section C of the financial statements of the Company from page 161 to page 163 of this report.

The following table sets forth each of its segments' income and profit from principal operations, costs of sales, taxes and surcharges, as prepared under the PRC Accounting Rules and Regulations.

	Years Ended 31 December	
	2006	2005
	RMB millions	RMB millions
Income from principal operations		
Exploration and Production Segment	128,938	104,285
Refining Segment	570,772	469,266
Marketing and Distribution Segment	592,871	462,464
Chemicals Segment	221,432	172,982
Others	261,468	121,265
Elimination of inter-segment sales	(730,902)	(531,147)
Consolidated income from principal operations	1,044,579	799,115
Cost of sales, sales taxes and surcharges		
Exploration and Production Segment	53,052	40,118
Refining Segment	595,118	477,843
Marketing and Distribution Segment	536,381	427,308
Chemicals Segment	196,274	149,431
Others	258,977	118,152
Elimination of inter-segment cost of sales	(731,487)	(527,451)
Consolidated cost of sales, sales taxes and surcharges	908,315	685,401
Profit from principal operations		
Exploration and Production Segment	76,022	59,732
Refining Segment	(23,897)	(7,838)
Marketing and Distribution Segment	56,490	35,156
Chemicals Segment	25,158	23,551
Others	2,491	3,113
Consolidated profit from principal operations	136,264	113,714
Net profit	50,664	39,558

Profit from principal operations: in 2006, the Company's realised profit from principal operations was RMB 136.3 billion, representing an increase of RMB 22.6 billion over 2005. The increase was mainly due to the fact that the Company implemented the

resource strategy, proactively expanded the market share, optimised refining and petrochemical production, and made great efforts on safety management, resource conservation and expense reduction.

Net profit: in 2006, the net profit realised by the Company was RMB 50.7 billion, representing an increase of RMB 11.1 billion, or 28.1%, over 2005.

Financial data prepared under the PRC Accounting Rules and Regulations:

Unit: RMB millions

	At 31 December		
	2006	2005	Changes
Total assets	594,550	520,572	73,978
Long-term liabilities	109,860	107,774	2,086
Shareholders' funds	254,875	215,623	39,252

Analysis of changes:

Total assets: By the end of 2006, the total assets increased by RMB 74.0 billion over 2005 to RMB 594.6 billion. The increase was primarily due to a number of factors, of which, the fixed assets increased by RMB 57.4 billion with the Company's implementation of the investment plan; long-term equity investment increased by RMB 13.3 billion mainly as a result of the acquisition of minority interests in subsidiaries.

Long-term liabilities: By the end of 2006, the Company's long-term liabilities were RMB 109.9 billion, representing an increase of RMB 2.1 billion over 2005, which was primarily due to the increase in long-term borrowings for funding the investment plan.

Shareholders' funds: At the end of 2006, shareholders' funds of the Company was RMB 254.9 billion, representing an increase of RMB 39.3 billion over 2005. The increase was primarily due to: first, the realised net profit in 2006 of RMB 50.7 billion; second,

in 2006, the distribution of the final dividend of 2005 and the interim dividend for 2006 totalling RMB 11.3 billion.

(7) Significant differences between the financial statements prepared under IFRS and US GAAP

The major differences between the Company's financial statements prepared under IFRS and US GAAP are set out in Section E of the financial statements of the Company from page 168 to page 170 of this report.