Management's Discussion and Analysis

Our consolidated net profit for 2000 was Rmb10,296.6 million (US$1,243.6 million), an increase of Rmb6,185.2 million (US$747.0 million), or 150.4% from Rmb4,111.4 million in 1999. The increase reflected both higher crude oil prices and higher production and exchange gains resulting from a Japanese yen depreciation.

Oil and gas sales for 2000 were Rmb18,819.3 million (US$2,272.9 million), an increase of Rmb7,421.4 million (US$896.3 million), or 65.1%, from Rmb11,397.9 million in 1999, primarily due to an increase in crude oil prices and higher oil and gas sales volumes. Our net realized crude oil price averaged US$28.21 per barrel in 2000, an increase of US$9.3 or 49.2%, from US$18.91 per barrel in 1999, due to the increase in international oil prices. Our net realized natural gas price averaged US$3.09 per thousand cubic feet in 2000, up US$0.21, or 7.3% from US$2.88 per thousand cubic feet in 1999. Our natural gas prices are determined by negotiations between us and the buyers under market conditions. The rise in realized pricing mainly reflected a proportional increase in the amount of gas sold to customers under higher contracted prices. Our net crude oil and condensate production in 2000 averaged approximately 206,347 barrels per day, rising 31,602 barrels per day, or 18.1% compared to 174,745 barrels per day in 1999. The increase in production primarily resulted from new oil properties commencing production during 2000, including Qikou 17-2, Huizhou 26-1N, Suizhong 36-1 (Phase II), and a full year of production from Weizhou 12-1 and Jinzhou 9-3. Such production additions were offset by declining production in some of the mature oil properties. Net natural gas production in 2000 averaged 197.9 million cubic feet per day, a slight decrease of approximately 6.5 million cubic feet, or 3.2%, from 204.4 million cubic feet per day in 1999. Our net natural gas production decrease in 2000 resulted from a reduction in our production at Yacheng 13-1, which was partially offset by the increase of production resulting from a full year's production of the Pinghu field, which commenced operations in 1999.

Other income was Rmb278.6 million (US$33.6 million) in 2000, which increased Rmb170.3 million, or 157.2%, compared to Rmb108.3 million in 1999. The increase was mainly due to the increase of project management fees and handling fees.

Operating expenses for 2000 were Rmb2,124.1 million (US$256.5 million), an increase of Rmb268.8 million (US$32.5 million), or 14.5%, from Rmb1,855.3 million in 1999, primarily due to increased operations from new oil and gas properties which commenced production in 2000 and increased prices of fuel, rental and services as well as increased well operating costs attributable to more mature crude oil producing properties. As a result of higher production, on a unit of production basis, our operating expenses in 2000 maintained the 1999 level of Rmb24.76 (US$2.99) per barrel-of-oil equivalent.

Production taxes for 2000 were Rmb1,036.7 million (US$125.2 million), an increase of Rmb457.8 million (US$55.3 million), or 79.1%, from Rmb578.9 million in 1999, due to higher oil prices as well as the increase in crude oil and gas production in 2000.

Exploration costs for 2000 were Rmb552.9 million (US$66.8 million), an increase of Rmb306.5 million (US$37.0 million), or 124.4%, from Rmb246.4 million in 1999, primarily due to our higher exploration budget in 2000 as a result of the increase in oil prices in 1999 and a lower drilling success rate in 2000. Our exploration costs relate only to our independent exploration activities, as exploration costs under our production sharing contracts are funded solely by our foreign partners. Because we use the successful effort method of accounting, our exploration costs do not include the costs of drilling and equipping successful wells. These amounts are capitalized and amortized on a unit of production basis.

Depreciation, depletion and amortization expense for 2000 was Rmb2,577.9 million (US$311.3 million), an increase of Rmb204.5 million (US$24.7 million), or 8.6%, from Rmb2,373.4 million in 1999, primarily due to the growth in crude oil production. On a per unit basis, depreciation, depletion and amortization expense was Rmb30.0 (US$3.62) per barrel-of-oil equivalent in 2000, decreased by 5.7% as compared to Rmb31.8 per barrel-of-oil equivalent in 1999.

Dismantlement and site restoration allowance for 2000 was Rmb103.6 million (US$12.5 million), a decrease of Rmb73.5 million (US$8.9 million), or 41.5%, from Rmb177.1 million (US$21.4 million) in 1999 due to full provision of the allowance for certain mature fields in earlier years.

Crude oil and product purchases for 2000 were Rmb5,097.8 million (US$615.7 million), an increase of Rmb1,361.1 million (US$164.4 million), or 36.4%, from Rmb3,736.7 million (US$451.3 million) in 1999. Upon the request of our foreign partner, we purchase their share of crude oil for resale in China, since we are one of the only three companies authorized to market and sell crude oil in the PRC. We do not have control over our foreign partners' decisions regarding the sale of their share of production and, therefore, have no control over the volume that we may be asked to handle in any particular period. The marketing revenue of our Singapore subsidiary also increased as a result of increases in oil prices.

Selling and administrative expenses for 2000 were Rmb456.0 million (US$55.1 million), a decrease of Rmb60.5 million (US$7.3 million), or 11.7%, from Rmb516.5 million in 1999, primarily due to write -back of doubtful accounts, partially offset by an increase of salary and staff benefits, as well as utility, office, transportation, and selling expenses. On a unit of production basis, selling and administrative expenses were Rmb5.3 (US$0.62) per barrel-of-oil equivalent of production in 2000. This compares favorably with Rmb6.9 (US$0.83) per barrel-of-oil equivalent in 1999.

Net interest expense for 2000 was Rmb238.4 million (US$28.8 million), down Rmb329.6 million (US$39.8 million), or 58%, from Rmb568.0 million (US$68.6 million) in 1999, primarily due to an increase in interest income resulting from higher cash balances and lower interest expenses resulting from lower outstanding debts.

Exchange gain for 2000 was Rmb381.3 million (US$46.1 million), an increase of Rmb813.3 million (US$98.2 million) compared to the losses of Rmb432.0 million (US$52.2 million) in 1999. The exchange gain or loss in each period mainly represents foreign exchange gains or losses on our Japanese yen denominated debt through the depreciation or appreciation of the Japanese yen against the Renminbi.

Other expenses for 2000 were Rmb217.6 million (US$26.3 million), an increase of Rmb212.2 million (US$25.6 million) compared to Rmb5.4 million in 1999, due to the increase in expenses related to the disposal of obsolete materials.

The share of profit from our associated company for 2000 was Rmb218.3 million (US$26.4 million), an increase of Rmb205.0 million (US$24.8 million) compared to Rmb13.3 million (US$1.6 million) in 1999. This profit represents our 30% equity interest in the net profit of Shanghai Petroleum and Natural Gas Company Limited, the owner of the Pinghu field which commenced commercial operations in 1999. The increase in 2000 was primarily due to the higher, full-year production in 2000 and higher prices for the petroleum sales.

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Non-operating loss for 2000 was Rmb196.0 million (US$23.7 million), an increase of Rmb195.1 million from Rmb0.9 million in 1999, primarily due to disposal of obsolete offshore equipment.

Provision for taxation in the year 2000 was Rmb1,926.1 million (US$232.6 million), an increase of Rmb1,204.2 million (US$145.4 million), or 166.8%, from Rmb721.9 million in 1999, primarily due to an increase in taxable profit. The provision for both 2000 and 1999 reflected a reduced income tax rate for our PRC subsidiary, which expired on December 31, 2000. Accordingly, the future enterprise income tax rate for our PRC subsidiary will be higher than that reflected in this report.

Liquidity and Capital Resources

	Years ended December 31	
	2000	1999
	(Amounts in millions of Rmb)	
Cash provided by (used for):		
Operating activities	**14,436.1**	8171.8
Returns on investments and servicing of finance	**(4,391.4)**	(651.1)
Taxation	**(880.1)**	(197.5)
Investing activities	**(7,860.6)**	(4,442.1)
Financing	**620.1**	(2,428.1)
Net increase in cash	**1,924.1**	453.0

Cash Provided by Operations and Working Capital

Cash provided by operating activities in 2000 rose Rmb6,264.4 million (US$756.6 million), or 76.7%, to Rmb14,436.1 million (US$1,743.5 million), from Rmb8,171.7 million (US$986.9 million) in 1999. This increase resulted primarily from an increase in income before tax of Rmb7,389.3 million (US$892.4 million), an increase of unrealized exchange gain of Rmb726.7 million (US$87.8 million), and an increase of depreciation, depletion and amortization expense of Rmb204.5 million (US$24.7 million) which was offset by a decrease in dismantlement and site restoration allowance of Rmb73.5 million, and an increase in unreceived share of profit of an associated company of Rmb205.0 million.

In addition, our operating cash flow was adversely affected by a net increase in working capital of Rmb326.4 million (US$39.4 million). The increase in working capital resulted from a decrease in accounts payable and accrued liabilities of Rmb1433.9 million, and an increase in other current assets of Rmb39.4 million, which was partially offset by decrease in accounts receivable of Rmb1,146.6 million.

We had a working capital surplus of Rmb704.2 million at December 31, 2000, up Rmb4,893.9 million compared to a deficit of Rmb4,189.7 million at December 31, 1999. The increase in net working capital mainly resulted from Rmb3,769.7 million received from our issuance of new shares in 2000 during the private placements and a decrease in short-term bank loans and current portion of long term bank loans of Rmb2,071.8 million, as well as a decrease of accounts payable and accrued liabilities of Rmb1,460.3 million. This was partially offset by a decrease in accounts receivable of Rmb1,089.0 million and an increase in dividends payable of Rmb2,352.0 million and taxes payable of Rmb767.1 million.

Capital Expenditures and Investments

Our total capital expenditures were Rmb4,404.0 million (US$531.9 million) in 2000, an increase of Rmb334.3 million, or 8.2%, from Rmb4,069.7 million in 1999. Our capital expenditures in 2000 consisted of Rmb57.0 million for capitalized exploration activities and Rmb3,996.0 million for development activities. Our 2000 development expenditures related principally to the development of fields including Suizhong 36-1 (Phase II), Qinhuangdao 32-6, Wenchang 13-1/13-2 and Qikou 17-2.

Financing

We had net cash flows from financing of Rmb620.1 million (US$74.9 million) in 2000. Our net cash flows from financing in 2000 primarily resulted from net proceeds of Rmb3,769.7 million (US$455.3 million) from the issuance of new shares to our corporate investors in 2000, offset in part by cash outflows of Rmb3,371.7 million (US$407.2 million) for repayment of bank loans.

The following table summarizes the maturities of our long-term debt outstanding as of December 31, 2000.

(Amounts in millions of Rmb)	
2001	997
2002	1,281
2003-2005	1,868
After 2005	1,600
Total	5,746

Market Risks

Our primary market risk exposures are fluctuations in oil and gas prices, exchange rates and interest rates.

Commodity Price Risks

We are exposed to fluctuations in prices of crude oil and natural gas, which are commodities whose prices are determined by reference to international market prices. International oil and gas prices are volatile and this volatility has a significant effect on our net sales and net income. We do not hedge market risk resulting from fluctuations in oil and gas prices.

Foreign Exchange Risk

Our foreign exchange exposure gives rise to market risk associated with exchange rate movements.

We maintain our accounts in Rmb and most of our revenues and expenses are denominated in Rmb. While our domestic sales are denominated in Rmb, our domestic oil and gas prices are quoted in U.S. dollars based on international U.S. dollar oil prices and are billed and paid in Rmb based on the Rmb to U.S. dollar exchange rates prevailing at the time of billing. Accordingly, substantially all of our domestic sales are U.S. dollar 'linked.' We also have some U.S. dollar revenues from exports of oil.

We are exposed to foreign exchange risk related to our debt because a substantial portion of our loans is denominated in foreign currencies, principally U.S. dollars and Japanese yen. Foreign currency denominated loans, principally denominated in U.S. dollars, totaled the equivalent of Rmb4,638.1 million (US$560.2 million) and Rmb2,613.4 million (US$315.6 million) as of December 31, 1999 and 2000, respectively, representing 51.0% and 45.5%, respectively, of our total loans as of those dates. Our yen-denominated loans were JPY40,739 million and JPY32,900 million as of December 31, 1999 and 2000, respectively, representing 36.3% and 41.5% of the total outstanding loans, respectively. We entered into two U.S. dollar-Japanese yen currency swaps relating to a portion of our yen-denominated debt, one of which was unwound on March 31, 2000.

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In addition, we are exposed to foreign exchange risk related to our capital expenditures because a portion of our capital expenditures represents imported equipment that is purchased in foreign currencies, principally U.S. dollars. During the years ended December 31, 1999 and 2000, approximately 35% and 27%, respectively, of our capital expenditures were denominated in foreign currencies, principally in U.S. dollars.

We believe that our U.S. dollar-denominated and U.S. dollar-linked revenues partially limit our foreign exchange risk. However, any depreciation in the value of the Rmb versus the U.S. dollar or Japanese yen could adversely affect the results of our operations and financial condition. This could include potential increases in the Rmb cost to us of servicing our foreign currency debt and the amount of our foreign currency debt as expressed in Rmb on our balance sheet. Any increase would result in a foreign exchange loss that would be reflected as a noncash expense on our income statement in the year it occurs, an interest expense on our foreign currency debt as expressed in Rmb on our income statement, and an increase in the Rmb cost to us of our foreign currency capital expenditures and other foreign currency expenditures.

Interest Rate Risk

We are also exposed to interest rate risk arising from our short-term and long-term loans. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding floating rate borrowings. A substantial portion of our long-term borrowings have floating interest rates which are determined by reference to the London Interbank Offered Rate ("LIBOR") or floating interest rates quoted by local banks.

We use interest rate swap transactions occasionally to adjust our interest rate exposure when considered appropriate, based on existing and anticipated market conditions. Our policy is to match the interest payments under the interest rate swap agreements to the interest rate obligations due under underlying loan agreements so that the interest rate swaps qualify for hedge accounting. Interest rate differentials are reflected as an adjustment to interest expense over the life of the swap agreement.

Our interest rate swaps are entered into with major financial institutions, thereby minimizing the risk of any credit loss.