

number of levels with separated powers, thereby improving the efficiency of capital employment and return on capital employed. In accordance with the principles of the market, the Company has established an independent decision-making regime and perfected a scientific decision-making system. It has persistently implemented prudent investment policies and raised investment returns in 2000 to 15.8%.

The Company has established a standardised incentive mechanism, which includes mechanisms for reviewing the performance and remuneration of 300 senior management personnel. At the same time, more vigorous efforts have been made in auditing and supervision to ensure the standardisation of operations and the accuracy of accounting and operating data. These measures have raised the enthusiasm of the management and also strengthened the supervision and control mechanism.

The Company has rebuilt its information system. Originating from financial management, corporate resources planning and e-commerce, a web-based operating system has been established to speed up the Company's response to market demands.

In the course of its production and operation, the Company pays great attention to the prevention of production-related accidents, the protection of the employees' safety and health, the improvement of product quality, the reduction in energy consumption and the protection of the natural environment. The Company pursues the aim of on-going improvement in the overall living quality of mankind and actively establishes and implements the HSE (Health, Safety and Environment) management system. It effects an organic merger of the HSE system with each production and operating activity, so that each employee will be responsible for upholding the HSE system.

The Company is committed to fulfil the undertakings it has made to investors. The Company appoints particular departments and employees to oversee the fulfilment of each particular undertaking it has made to investors, so that such undertakings can be fulfilled one by one. Some undertakings, such as those regarding the Company's relationship with the government, its relationship with the parent company, the lowering of costs and workforce reduction, have all been satisfactorily fulfilled. In particular, with regard to its undertaking in relation to connected transactions, which is a major concern of investors, the Company has strictly complied with the terms of the Comprehensive Products and Services Agreement and other connected transaction agreements it has entered into with its parent company and has operated in accordance with the provisions of such agreements.

Through restructuring and standardised operations, the Company has achieved remarkable results in its core business and substantial improvement in its profitability. The year 2000 saw an increase in oil and gas reserves and total output, an increase in the output of refining and chemical products and a continuous expansion of the marketing and distribution network. At the same time, crude oil exploration cost, lifting cost and refining cost all decreased correspondingly. These factors, together with the rise in crude oil prices, have brought about

a significant increase in the Company's profit.

Apart from working on present restructuring and management, the Company also focuses on its on-going and steady development in the long term. We have formulated a development strategy, which aims to speed up the development of our core businesses, reduce costs and pursue technological innovation and on-going restructuring.

By making full use of our advantage in terms of oil and gas reserves, we will strive to secure our leading position in China's oil and gas industry and continue to increase our oil and gas reserves. In particular, we will speed up the development of the natural gas segment and the construction of pipelines, thereby turning our advantage in resources into an advantage in terms of markets. At the same time, we will speed up the restructuring of the refining segment and keep increasing our resistance to risks by further integrating our upstream and downstream businesses.

We have full confidence in the future. Having reformulated the concepts of management, the Company will, under the supervision and with the support of its investors, continue to increase its value to become a first-rate major oil company in the world.

The Board of Directors

The board of directors currently consists of 13 directors, including three independent non-executive directors. Mr Zhang Hong and Mr Jiang Jiemin ceased to be directors of the Company effective from May 30, 2000 and June 30, 2000, respectively. Both Mr Zhang and Mr Jiang have been appointed as senior government officials. In accordance with PRC laws, they cannot continue to act as directors of the Company.

The Company is very honoured to have appointed Mr Franco Bernabè as the independent non-executive director of the Company, and Mr Zheng Hu and Mr Wang Fucheng as directors of the Company. Their appointments were approved by shareholders in the annual general meeting held on June 30, 2000.

Mr Bernabè is the Chairman of Franco Bernabè Group and Vice Chairman of H3G, Chairman of Kelyan, a member of the board of Fiat and of TNT Post Group. He serves in the Executive Committee of Confindustria, the Italian Confederation of Industry, the Board of the Peres Centre for Peace and the International Board of the World Economic Forum. He also served as a special representative of the Italian government for the reconstruction of the Balkan region. He was a former Chief Executive Officer of ENI and Telecom Italia, and was the head of economic studies of Fiat .

Mr Zheng Hu graduated from the Mining Industry and Machinery Department of the Beijing Petroleum Institute in 1970. Mr Zheng is a senior engineer and has over 30 years' experience in China's oil and gas industry. From 1992 to 1999, Mr Zheng worked as Deputy General Manager and General Manager of China Petroleum Materials and Equipment (Group)

Corporation. Mr Zheng is a Deputy General Manager of CNPC.

Mr Wang Fucheng graduated from the Chinese Faculty of the Shandong Teacher's University and has over 30 years' experience in China's oil and gas industry. From 1986 to 1999, Mr Wang worked as Senior Executive of the Shengli Oil Field, Deputy Director of the Liaohe Oil Exploration Bureau and Director of the Liaohe Oil Exploration Bureau. Mr Wang is a Vice President of the Company.

Finally, I would like to take this opportunity to express my sincere thanks for the loyal support of our shareholders, the valuable contribution of our board of directors and supervisory committee and the hard work of all our employees.

Ma Fucai
Chairman
Beijing, the PRC
April 23, 2001