

MANAGEMENTS' DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

When reading the following discussion, you are also advised to jointly read the consolidated statements of the Group and their notes contained in this annual report and other sections.

Our consolidated financial statements and operating data present, and the discussion and analysis in this annual report pertain to, the results of operations of the businesses transferred to us by China National Petroleum Corporation ("CNPC") and are based on the historical financial information of CNPC. Specifically, in connection with the 1998 restructuring of China's oil and gas industry, CNPC transferred to Sinopec six crude oil and natural gas production enterprises located in the eastern and coastal regions of China and Sinopec transferred to CNPC 15 refineries and petrochemical plants located in the northeastern, northern and western regions of China. In addition, local governments in the northeastern, northern and western regions of China transferred to CNPC 15 provincial and municipal petroleum distribution companies. Our financial and operating information gives effect to these transactions for all periods presented. A significant portion of revenues generated prior to the asset transfer represented sales from our exploration and production segment to Sinopec.

We are engaged in a broad range of petroleum related activities, including:

- the exploration, development and production of crude oil and natural gas;
- the refining, transportation, storage and marketing, including import and export, of crude oil and petroleum products;
- the production and sale of chemicals; and
- the transmission, marketing and sale of natural gas.

We are China's largest producer of crude oil and natural gas and one of the largest companies in China in terms of sales. In the year ended December 31, 1999/2000, we produced approximately 765.4 million barrels of crude oil and approximately 503.8 billion cubic feet of natural gas for sale. Our refineries processed approximately 547.0 million barrels of crude oil in the year ended December 31, 2000. In the year ended December 31, 2000, we had total revenues of RMB 241,992 million and net income of RMB 55,231 million.

Operating Results

The following discussion is based on our historical results of operations. Such results of operations may not be indicative of our future operating performance.

Our income statement for each of the three years ended December 31, 2000 is summarised

in the table below:

	Year ended December 31,		
	<u>1998</u>	<u>1999</u>	<u>2000</u>
	(RMB in millions)		
Total revenues	147,287	175,969	241,992
Operating expenses	(111,798)	(129,069)	(156,233)
Income from operations	<u>35,489</u>	<u>46,900</u>	<u>85,759</u>
Exchange gain (loss), net	(1,872)	(2,233)	1,172
Interest expense, net	(10,950)	(8,264)	(5,464)
Income from equity affiliates	88	128	584
Income before income taxes	22,755	36,531	82,051
Income taxes	(7,537)	(9,403)	(26,985)
Net income	<u>15,275</u>	<u>27,001</u>	<u>55,231</u>

The table below sets forth our revenues by business segment for each of the three years ended December 31, 2000, as well as the percentage changes in revenues for the periods shown.

			1999		
	1998	1999	vs. 1998	2000	vs. 1999
	(RMB in millions, except percentages)				
Sales and Other Operating Revenues					
Exploration and production	89,626	110,190	22.9%	170,928	55.1%
Refining and marketing	100,105	117,562	17.4	161,148	37.1
Chemicals	21,849	25,417	16.3	33,364	31.3
Natural gas	5,320	5,977	12.4	7,163	19.8
Other	309	312	1	-	-
Total	217,209	259,458	19.5%	372,603	43.6%
Less intersegment sales	(69,922)	(83,489)	19.4	(130,611)	56.4
Consolidated net sales from operations	147,287	175,969	19.5%	241,992	37.5%

The table below sets forth our operating income by business segment for each of the three years ended December 31, 2000, as well as the percentage changes in operating income for the periods shown. Other income from operations shown below consists of research and development, business services and infrastructure support to our operating business segments.

	1999		2000	
	1998	1999	1998	2000
			vs.	vs.
			1998	1999
	(RMB in millions, except percentages)			
Income From Operations				
Exploration and production	35,509	50,895	43.3%	86.9%
Refining and marketing	3,589	(487)	(113.6)	(1,695.1)
Chemicals	(1,808)	(1,704)	(6.1)	104.1
Natural gas	(226)	(415)	83.6	103.4
Other	(1,575)	(1,389)	(13.4)	(47.7)
Total	35,489	46,900	32.2%	82.9%

Year Ended December 31, 2000 Compared to Year Ended December 31, 1999

Total Revenue. Total revenue increased 37.5% from RMB 175,969 million for the year ended December 31, 1999 to RMB 241,992 million for the year ended December 31, 2000. This increase reflected an increase in revenues in each of our business segments due primarily to increases in the prices of crude oil, refined products and natural gas as well as increased sales volume of our chemical and natural gas segments.

Operating Expenses. Operating expenses increased 21.0% from RMB 129,069 million for the year ended December 31, 1999 to RMB 156,233 million for the year ended December 31, 2000. This increase resulted primarily from increases in depreciation, depletion and amortisation, expenses associated with workforce reduction and shutting down of inefficient refining and chemical units and facilities, selling, general and administrative expenses, employee compensation costs and taxes other than income taxes.

Purchases, Services and Other. Purchases, services and other expenses increased 1.8 % from RMB 61,470 million for the year ended December 31, 1999 to RMB 62,598 million for the year ended December 31, 2000. This increase reflected primarily increases in crude oil purchase expenses in our refining and marketing segment, prices of feedstock in our chemical segment, as well as purchase expenses resulted from increased sales volume in our natural gas segment.

Employee Compensation Costs. Employee compensation costs increased 30.4% from RMB 11,064 million for the year ended December 31, 1999 to RMB 14,430 million for the year ended December 31, 2000. This increase was primarily due to our new employee compensation system adopted in 2000, and increases in salary and certain benefit expenses. Such increase in benefit expenses was primarily attributable to a change in the classification of expenses.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased 32.2% from RMB 12,596 million for the year ended December 31, 1999 to RMB 16,649 million for the year ended December 31, 2000. This increase was due primarily to an increase of land lease expenses (no such expenses were paid by the Company prior to its