

## **MANAGEMENTT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

For the six months ended June 30, 2001, profit before taxation of the Group was RMB39,998 million, representing an increase of 15.4% compared with the corresponding period last year. Net profit was RMB27,168 million, representing an increase of 17.8% compared with the corresponding period last year. The Group attributes the increase in profitability to increases in prices of principal products, a rise in sales, and the continuous implementation of on-going restructuring and cost reduction strategies following the listing of the Company. Profits were primarily derived from the sale of crude oil from the Group's exploration and production segment.

In reviewing the following discussion, please also refer to the Company's consolidated financial statements and their notes contained in this interim report.

### **Overview**

For the six months ended June 30, 2001, profit before taxation of the Group was RMB39,998 million, representing an increase of 15.4% compared with the corresponding period last year. Net profit was RMB27,168 million, representing an increase of 17.8% compared with the corresponding period last year. The Group attributes the increase in profitability to increases in prices of principal products, a rise in sales, and the continuous implementation of on-going restructuring and cost reduction strategies following the listing of the Company. Profits were primarily derived from the sale of crude oil from the Group's exploration and production segment.

Basic and diluted earnings per share of the Company for the six months ended June 30, 2001 was RMB0.15.

**Six Months Ended June 30, 2001 Compared To Six Months Ended June 30, 2000**

**Consolidated Operating Results**

*Turnover* Turnover increased 10.2% from RMB110,896 million for the six months ended June 30, 2000 to RMB122,169 million for the six months ended June 30, 2001. This reflects the increase in revenue of the Group's refining and marketing segment and natural gas and pipelines segment due mainly to higher prices and sales volume of refined products and an increase in the sales volume of natural gas.

*Operating Expenses* Operating expenses increased 9.7% from RMB73,565 million for the six months ended June 30, 2000 to RMB80,671 million for the six months ended June 30, 2001. This was due primarily to the increased expenses in purchases, services and other expenses, selling and administrative expenses as well as taxes other than income taxes.

*Purchases, Services and Other Expenses* Purchases, services and other expenses increased 14.9% from RMB30,584 million for the six months ended June 30, 2000 to RMB35,129 million for the six months ended June 30, 2001. This mainly reflects the increased crude oil purchase expenses resulting from a higher volume of processed oil by the refining and marketing segment, increases of raw chemical material prices as well as larger volume of natural gas being purchased.

*Employee Compensation Costs* Employee compensation costs increased 0.6% from RMB6,291 million for the six months ended June 30, 2000 to RMB6,328 million for the six months ended June 30, 2001.

*Selling, General and Administrative Expenses* Selling, general and administrative expenses increased 26.6% from RMB8,162 million for the six months ended June 30, 2000 to RMB10,334 million for the six months ended June 30, 2001. This increase was due primarily to the higher transportation costs resulting from an increased sales volume in the refining segment and increases in sales and administrative costs of the entities covered by the consolidated financial statements in relation to an expansion of the

sales and distribution networks and the acquisition of service stations. Higher selling, general and administrative expenses also resulted from increases in losses relating to the bad debts in the chemicals and marketing segment.

*Depreciation, Depletion and Amortisation* Depreciation, depletion and amortisation increased 1.0% from RMB18,009 million for the six months ended June 30, 2000 to RMB18,195 million for the six months ended June 30, 2001.

*Taxes Other than Income Taxes* Taxes other than income taxes increased 12.1% from RMB6,591 million for the six months ended June 30, 2000 to RMB7,390 million for the six months ended June 30, 2001. This increase was due primarily to an increase in sales tax and other relevant taxes resulting from an increased sales volume in the refining and marketing segment.

*Profit From Operations* Profit from operations increased 11.2% from RMB37,331 million for the six months ended June 30, 2000 to RMB41,498 million for the six months ended June 30, 2001.

*Net Exchange Gain (Loss)* Net exchange gain decreased 68.0% from RMB896 million for the six months ended June 30, 2000 to RMB287 million for the six months ended June 30, 2001. This decrease was due to the repayment of a substantial amount of foreign currency loans in the first half of 2000.

*Net Interest Expense* Net interest expense decreased 44.3% from RMB3,753 million for the six months ended June 30, 2000 to RMB2,090 million for the six months ended June 30, 2001. This decrease was due primarily to decreases in the interest rates on foreign borrowings, decreases in foreign borrowings, and repayments of loans resulting in a substantial decrease in the average balance of debts.

*Profit Before Taxation* Profit before taxation increased 15.4% from RMB34,646 million for the six months ended June 30, 2000 to RMB39,998 million for the six months ended June 30, 2001.

*Taxation* Taxation increased 14.6% from RMB11,482 million for the six months ended June 30, 2000 to RMB13,160 million for the six months ended June 30, 2001 due primarily to an increase in profit before taxation.

*Net Profit* Net profit increased 17.8% from RMB23,069 million for the six months ended June 30, 2000 to RMB27,168 million for the six months ended June 30, 2001.

## **Segment Information**

The Group is engaged in a broad range of petroleum and related activities through its four major business segments: the exploration and production segment, the refining and marketing segment, the chemicals and marketing segment, and the natural gas and pipelines segment.

### **Exploration and Production**

The exploration and production segment is engaged in the exploration, development, production and sale of crude oil and natural gas.

*Turnover* Turnover decreased 3.2% from RMB81,442 million for the six months ended June 30, 2000 to RMB78,849 million for the six months ended June 30, 2001. This decrease was due primarily to a decrease in the sales of our crude oil (not including condensate) and a decline in its average realised selling price. As the Company's oil prices are directly linked to the international oil prices, declines in the international oil prices have therefore caused a decrease of 2.7% in the Company's average realised selling price of crude oil, from RMB209.82 per barrel in the six months ended June 30, 2000 to RMB204.10 per barrel in the six months ended June 30, 2001.

Intersegment sales increased 2.4% from RMB57,032 million for the six months ended June 30, 2000 to RMB58,393 million for the six months ended June 30, 2001. This increase was due primarily to an increase in the volume of crude oil sold to other business segments.

*Operating Expenses* Operating expenses decreased 3.2% from RMB38,186 million for the six months ended June 30, 2000 to RMB36,951 million for the six months ended June 30, 2001. This decrease was due primarily to decreases in purchase, service and other expenses and decreases in exploration expenses.

*Profit From Operations* Profit from operations decreased 3.1% from RMB43,256 million for the six months ended June 30, 2000 to RMB41,898 million for the six months ended June 30, 2001.

## Refining and Marketing

**The refining and marketing segment is engaged in the refining of crude oil, transportation, storage and marketing of petroleum products.**

*Turnover* Sales and other operating revenue increased 22.2% from RMB70,666 million for the six months ended June 30, 2000 to RMB86,380 million for the six months ended June 30, 2001. This increase was due primarily to increases in the sales volume of diesel oil and gasoline. The increase was also due to the fact that, whereas prior to June 2000, the prices of domestic refined products were adjusted by the government with reference to the prices of refined products on the international markets, since June 2000 prices in the domestic refined products market have been directly linked to prices in the international refined products market, with adjustments on a monthly basis. The increase in total revenue was also primarily due to increases in the prices of gasoline, kerosene, diesel oil and lubricants, as a result of a general recovery in the refined products market.

Sales revenue from gasoline increased 33.2% from RMB18,008 million for the six months ended June 30, 2000 to RMB23,992 million for the six months ended June 30, 2001. This increase was due primarily to an increase in the sales volume and in the average realised selling price of gasoline. The average realised selling price of gasoline increased 18.9%, from RMB2,289 per ton for the six months ended June 30, 2000 to RMB2,721 per ton for the six months ended June 30, 2001.

Sales revenue from diesel increased 29.0% from RMB28,596 million for the six months ended June 30, 2000 to RMB36,889 million for the six months ended June 30, 2001. This increase was due primarily to an increase in the sales volume and in the average realised selling price of diesel. The average realised selling price of diesel increased 12.7%, from RMB2,147 per ton in the six months ended June 30, 2000 to RMB2,419 per ton for the six months ended June 30, 2001.

Sales revenue from kerosene decreased 6.0% from RMB2,351 million for the six months ended June 30, 2000 to RMB2,217 million for the six months ended June 30, 2001. This decrease was due primarily to a decrease in the sales volume of kerosene.

Intersegment sales decreased 0.6% from RMB4,372 million for the six months ended June 30, 2000 to RMB4,346 million for the six months ended June 30, 2001.

*Operating Expenses* Operating expenses increased 10.7% from RMB77,529 million for the six months ended June 30, 2000 to RMB85,799 million for the six months ended June 30, 2001. This increase was due primarily to an increase in the cost of crude oil purchased as a result of an increase in the volume of crude oil processed.

*Profit From Operations* Profit from operations increased from a loss of RMB6,863 million for the six months ended June 30, 2000 to a gain of RMB581 million for the six months ended June 30, 2001.

## **Chemicals and Marketing**

**The chemicals and marketing segment is engaged in the production and marketing of basic petrochemical products, derivative petrochemical products, and other chemical products.**

*Turnover* Sales and other operating revenue decreased 5.2% from RMB16,787 million for the six months ended June 30, 2000 to RMB15,913 million for the six months ended June 30, 2001. This decrease was due primarily to overall decreases in the prices and sales volume of principal chemical products as a result of the downturn in the chemicals market.

*Operating Expenses* Operating expenses increased 8.3% from RMB15,456 million for the six months ended June 30, 2000 to RMB16,732 million for the six months ended June 30, 2001. This increase resulted primarily from increases in purchases, services and other expenses due to increases in the prices of raw materials. Operating expenses also increased due to higher sales and administrative expenses as a result of increased losses related to bad debts.

*Profit From Operations* Profit from operations decreased 161.53% from a gain of RMB1,331 million for the six months ended June 30, 2000 to a loss of RMB819 million for the six months ended June 30, 2001.

## **Natural Gas and Pipelines**

**The natural gas and pipelines segment is engaged in the transmission of crude oil and natural gas, and the sale of natural gas.**

*Turnover* Sales and other operating revenue increased 51.7% from RMB3,554 million for the six months ended June 30, 2000 to RMB5,391 million for the six months ended June 30, 2001. This increase was due primarily to an increase in the sales volume of natural gas and to the transfer of the pipeline transmission business from the refining and marketing segment to the natural gas and pipelines segment. The sales volume of natural gas increased 5.9% from 206.9 billion cubic feet in the six months ended June 30, 2000 to 219.1 billion cubic feet in the six months ended June 30, 2001.

*Operating Expenses* Operating expenses increased 49.9% from RMB3,489 million for the six months ended June 30, 2000 to RMB5,230 million for the six months ended June 30, 2001. This increase was due primarily to an increase in natural gas purchased and increases in the transmission costs for crude oil caused by the transfer of the pipeline transmission business from the refining and marketing segment.

*Profit From Operations* Profit from operations increased 147.7% from RMB65 million for the six months ended June 30, 2000 to RMB161 million for the six months ended June 30, 2001.

## **Liquidity and Capital Resources**

As at June 30, 2001, the Group's primary sources of funding were cash provided by operating activities, short-term and long-term borrowings, and cash and cash equivalents. The Group's funds were primarily used for capital expenditures, repayment of short-term and long-term borrowings, and distributions of dividends to shareholders.

As of the six months ended June 30, 2001, short-term debt comprised approximately 4.70% of our capital employed as compared with approximately 8.34% as of the six months ended June 30, 2000. Our ability to obtain adequate financing to satisfy our capital expenditures and debt servicing requirements may be limited by our financial condition and the results of operations, and by the liquidity of international and domestic capital markets. In addition, prior to accessing international capital markets, we must obtain approvals from various PRC government authorities. In general, we must obtain PRC government approvals for any project involving significant capital investment for our refining and marketing, and chemicals and natural gas segments.

We plan to fund the capital and related investments principally through the cash provided by operating activities, short-term and long-term debt, and cash and cash equivalents. Net cash provided by operating activities for the six months ended June 30, 2001 was RMB41,405 million. As of the six months ended June 30, 2001, we had cash and cash equivalents of RMB15,241 million. Cash and cash equivalents were primarily denominated in Renminbi (Renminbi accounting for approximately 96% and United States Dollar accounting for approximately 4%).

In the opinion of the management, our working capital is able to fulfil the present requirements for our investments and operations.

The table below sets forth our cash flows for each of the six months ended June 30, 2000 and 2001 and our cash equivalents at the end of each period.

	<u>Six months ended June 30,</u>	
	-----2001	-----2000
	(RMB million)	(RMB million)
Net cash provided by operating activities	41,405	57,623
Net cash used for investing activities	(24,973)	(17,840)
Net cash used for financing activities	(19,251)	(35,069)
Cash and cash equivalents at the end of each period	15,241	22,562

### **Cash Provided by Operating Activities**

Our net cash provided by operating activities decreased from RMB57,623 million for the six months ended June 30, 2000 to RMB41,405 million for the six months ended June 30, 2001. This decrease was due primarily to increases in income tax payments and receivables.

As at June 30, 2000, we had a working capital deficit of RMB4,065 million. As at June 30, 2001, we had a working capital surplus of RMB17,900 million. This surplus was due primarily to the repayment of our short-term liabilities with internally generated net cash flow in the six months ended June 30, 2001.



## Cash Provided by (Used for) Financing Activities

Our net borrowings for the year ended December 31, 2000 and for the six months ended June 30, 2001 were as follows:

	<u>June 30, 2001</u>	<u>December 31, 2000</u>
	(RMB million)	(RMB million)
<b>Short-term debt (including</b>		
<b>current portion of long-term debt)</b>	17,752	39,076
<b>Long-term debt</b>	69,452	53,341
<b>Total debt</b>	<u>87,204</u>	<u>92,417</u>
Less:		
Cash and cash equivalents	15,241	18,060
Short-term investments	12,270	5,815
Long-term investments	<u>5,506</u>	<u>4,784</u>
<b>Net debt</b>	<u>54,187</u>	<u>63,758</u>

The maturity profile of long-term debts of the Group is as follows:

	<u>Principal as at June 30, 2001</u>
	(RMB million)
To be repaid within one year	4,281
To be repaid within one to two years	6,567
To be repaid within three to five years	44,343
To be repaid after five years	<u>18,542</u>
	<u>73,733</u>

Of the total debts of the Group as at June 30, 2001, approximately 35% were fixed-rate loans and 65% were floating-rate loans. Of the total debts as at June 30, 2001, approximately 78.06% were denominated in Renminbi, approximately 18.00% were denominated in United States Dollar, approximately 1.66% were denominated in British Pound, approximately 1.21% were denominated in Japanese Yen, approximately 0.64% were denominated in French Franc, approximately 0.26% were denominated in Deutsche Mark and approximately 0.17% were denominated in Spanish Pesetas.

As at June 30, 2000 and June 30, 2001, the amount of short-term debts owed to the related parties was RMB8,548 million and RMB3,713 million, respectively. As at June 30, 2000 and June 30, 2001, the amount of long-term debts owed to the related parties were RMB8,164 million and RMB20,812 million, respectively.

As at June 30, 2001, our debts included short-term and long-term debts owed to China Petroleum Finance Company Limited of RMB3,708 million and RMB20,812 million, respectively.

Our net cash used for financing activities for the six months ended June 30, 2001 showed a decrease of 45.1% compared with the six months ended June 30, 2000. This decrease was primarily resulted from the following:

- an increase in new short-term loans leading to an increase of RMB10.897 billion cash inflow;
- an increase in new long-term loans leading to an increase of RMB18.634 billion

cash inflow;

- a decrease in the repayment of long-term loans leading to a decrease of RMB14.587 billion cash outflow;
- a decrease in the repayment of short-term loans leading to a decrease of RMB4.444 billion cash outflow;
- a distribution of RMB2.64 billion to CNPC in 2000, while no expenditure of the same kind in 2001, leading to a decrease in cash outflow as at June 30, 2001.

Such increase was offset by the following:

- an increase in the distribution of dividends leading to an increase of RMB14.473 billion cash outflow;
- new shares were issued in 2000 whereas no new shares has been issued during the period leading to a decrease of RMB20.336 billion cash inflow in six months ended June 30, 2001.

The bank loans secured by fixed assets as at June 30, 2001 amounted to RMB53 million (RMB230 million as at June 30, 2000).

The debt to capitalisation ratio (debt to capitalisation ratio = interest-bearing debts / (interest-bearing debts + shareholder's equity)) as at June 30, 2001 was 23.4% (26.5% as at June 30, 2000).

## **Capital Expenditures**

The table below sets forth our capital expenditures by business segment for each of the six months ended June 30, 2000 and the six months ended 2001. Capital expenditures increased 32.5% from RMB14,133 million for the six months ended June 30, 2000 to RMB18,727.8 million for the six months ended June 30, 2001. The increase was due primarily to an increase of investment in the oil and natural gas developments, and an increase of investment in the expansion of the refined products retail marketing network and storage infrastructure.

	As at June 30,					
	2000		2001		<u>2001(estimated value)</u>	
	(RMB million)	%	(RMB million)	%	(RMB million)	%
Exploration and production	11,330	80.17	13,265	70.83	38,343	60.5
Refining and marketing	1,669	11.81	4,035	21.55	11,940	18.9
Chemicals and marketing	855	6.05	590	3.15	4,090	6.4
Natural gas and pipelines	232	1.64	685	3.66	6,000	9.5
Other	.....47	...0.33	.....152	...0.81	.. 2,967	...4.7
Total	14.133	...100	18.727	...100	63.340	...100

### Exploration and Production

The majority of our capital expenditures and investments relates to the exploration and production segment. Capital expenditures for the six months ended June 30, 2001 totalled RMB13,265 million, including RMB3,159 million for exploration activities and RMB8,728 million for development activities. Capital expenditures for the six months ended June 30, 2000 totalled RMB11,330 million, including RMB3,156 million for exploration activities and RMB7,849 million for development activities. The increase in our capital expenditures from the six months ended June 30, 2000 to the six months ended June 30, 2001 was due primarily to an increase in the exploration and production activities to meet the requirements of business development.

We anticipate that capital expenditures and investments for our exploration and production segment for the year ended December 31, 2001 will amount to RMB38,343 million. Approximately RMB6,070 million is expected to be used for exploration activities and approximately RMB31,973 million for development activities. We plan to focus our exploration and production efforts in the Erdos, Tarim, Junggar, Songliao basins, Bohai Bay, Sichuan and Qaidam basins.

### Refining and Marketing

Capital expenditures for our refining and marketing segment for the six months ended June 30, 2001 was RMB4,035 million, of which RMB2,931 million was spent on the expansion of our refined product retail marketing network and storage infrastructure facilities, and RMB1,084 million was spent on the renovation of our refining facilities. Total capital expenditures for the six months ended June 30, 2000 were RMB1,669 million. The increase in capital expenditures from the six months ended June 30, 2000 to the six months ended June 30, 2001 was due primarily to an increase of investment in the expansion of refined product retail marketing network and storage infrastructure facilities.

We anticipate that capital expenditures and investments for our refining and marketing segment for the year ended December 31, 2001 will amount to RMB11,940 million, which include:

- approximately RMB6,040 million for the construction and expansion of refining facilities, including the expansion of our annual primary distillation capacity and the construction of catalytic reforming units at Dalian Petrochemical; and

- approximately RMB5,900 million for investments in our refined product retail marketing network in order to add more service stations and storage facilities.

### **Chemicals and Marketing**

Capital expenditures for our chemicals and marketing segment (excluding capital expenditures for assets retained by CNPC) for the six months ended June 30, 2001 decreased 30.99% from RMB855 million for the six months ended June 30, 2000 to RMB590 million for the six months ended June 30, 2001. The decrease in capital expenditures was due primarily to our adoption of a more rigorous return-based evaluation system, causing a substantial decrease in capital expenditures for the chemicals segment.

We anticipate that capital expenditures and investments for our chemicals and marketing segment for the year ended December 31, 2001 will amount to RMB4,090 million, which include the capital expenditures and investments for the construction of ethylene production facilities at Lanzhou Refinery.

### **Natural Gas and Pipelines**

Capital expenditures in our natural gas and pipelines segment for the six months ended June 30, 2001 totalled RMB685 million, of which RMB63 million was spent on the West-East gas pipeline project and RMB622 million was spent on the upgrading of existing pipelines and the construction of new pipelines. Capital expenditures for the six months ended June 30, 2000 totalled RMB232 million. The increase in our capital expenditures from the six months ended June 30, 2000 to the six months ended June 30, 2001 was due primarily to an increase in investment in the Se-Ning-Lan pipeline completion and the commencement of trial operation, the commencement of the initial preparation phase for the West-East gas pipeline project, and an increase in investment in the upgrading of existing pipelines.

We anticipate that capital expenditures and investments for our natural gas and pipelines segment for the year ended December 31, 2001 will amount to RMB6,000 million. Approximately RMB3,014 million is expected to be invested in the West-East gas pipeline project and the Zhong-Wu, Lan-Cheng-Yu and Se-Ning-Lan natural gas pipelines. We currently expect that approximately RMB1,106 million will be invested in the natural gas storage infrastructure projects and other natural gas pipelines and approximately RMB1,880 million will be used for investments in the transmission pipelines for crude oil and refined product.

## **Other**

Our non segment-specific capital expenditures and investments for the six months ended June 30, 2000 to the six months ended June 30, 2001 were RMB47 million and RMB152 million, respectively. Our non segment-specific capital expenditures and investments related primarily to the non segment-specific equipment purchases and research and development activities.

We anticipate that the Group's non segment-specific capital expenditures and investments for the year ending December 31, 2001 will amount to RMB2,967 million, which will be primarily used for the construction of water and electricity supply systems, and roads and telecommunications system to be used by various segments.

We anticipate that the Group's non segment-specific capital expenditures for the year ending December 31, 2001 will include:

- approximately RMB2,304 million for the construction of water and electricity supply systems, roads and telecommunications system;
- approximately RMB498 million for equipment purchases, and for non segment-specific research and development activities; and
- approximately RMB165 million for the improvement of our information technology system.

## **Foreign Exchange Rate Risk**

We conduct our business primarily in Renminbi. However, a portion of our Renminbi revenue is converted into other currencies to meet foreign currency financial instrument obligations and to pay for imported equipment and materials.

The Renminbi is not a freely convertible currency. Limitations on foreign exchange transactions imposed by the PRC government could cause future exchange rates to vary significantly from current or historical exchange rates. The fluctuations in Renminbi exchange rates will affect our ability to perform our foreign exchange denominated obligations. Such fluctuations will also affect our ability to pay dividends in Hong Kong Dollars or to pay dividends in respect of American depositary receipts in United States Dollars. We believe that the Company is or will be able to obtain sufficient foreign exchange for the performance of such obligations. We do not hedge against currency risks through the use of financial contracts or other agreements.

## Employees

### Number of Employees

As at June 30, 2000 and June 30, 2001, we had 473,518 and 430,226 employees, respectively. The table below sets forth the number of our employees by business segment as at June 30, 2001.

	<u>Number of Employees</u>	<u>% of Total</u>
Exploration and production	231,117	53.72
Refining and marketing	119,517	27.78
Chemicals and marketing	67,502	15.69
Natural gas and pipelines	9,766	2.27
Other <sup>(1)</sup>	<u>2,324</u>	<u>0.54</u>
Total	<u>430,226</u>	<u>100</u>

## Compensation

The total compensation payable by the Company for the six months ended June 30, 2001 was RMB 3,733 million, being the total monthly salaries of our employees during the report period. Compensation of our employees is determined according to industry practice and the actual conditions of the Company, and based on the principles of attracting and retaining the best people and motivating all staff for the realisation of the best results.

Our senior management compensation system links senior management members' financial interests (including those of our executive directors and our supervisors) with the Group's operating results and the market performance of our shares. Our senior management members have entered into performance contracts with us. Under this system, the senior management members' compensation has three components, namely, fixed salaries, performance bonuses and stock appreciation rights. The variable components in their compensation account for approximately 70% to 75% of our senior management officers' total potential compensation, including approximately 15% to 25% forming the performance bonus component and approximately 50% to 60% forming the stock appreciation rights component. Variable compensation rewards are linked to the attainment of specific performance targets, such as net income, return on capital and cost reduction targets. The chart below sets forth the components of the total potential compensation for key officers.

	% Basic .....salary	% Stock appreciation rights	% Performance .....bonus
Chairman	3.0	7.0	0
President	2.5	6.0	1.5
Vice President	2.5	6.0	1.5
Department GM	2.5	5.0	2.5



Details of the directors' and supervisors' emoluments for the six months ended June 30, 2000 and the six months ended June 30, 2001 are as follows:

	<u>Six months ended June 30.</u>	
	<u>.....2001</u> (RMB0 000)	<u>..... 2000</u> (RMB0 000)
Fee for directors and supervisors	8 7	8 3
Salaries, allowances and other benefits	4 9 8	2 7 7
Contribution to retirement benefit scheme	<u>.....11</u>	<u>.....12</u>
	<u>.....596</u>	<u>.....372</u>

The emoluments of the directors and supervisors fall within the following bands:

	<u>Six months ended June 30.</u>	
	<u>.....2001</u> Number	<u>..... 2000</u> Number
Nil - RMB1,000,000	<u>.....12</u>	<u>.....11</u>

### **Workforce Reduction Plan**

In the six months ended June 30, 2001, the Company reduced the number of employees by 14,000 and the actual expenditure for such reduction has amounted to RMB1.13 billion, of which RMB1.08 billion has been provided for in the profit and loss account of 2000.

### **Share Option Scheme**

The Company has granted share options to members of the senior management. Upon exercise of these share options, members of the senior management will not receive any shares in the Company, but will, by way of stock appreciation rights, receive a monetary sum which is calculated on the basis of the share price of the H shares listed on the HKSE.

### **Training Programmes**

The Company has established a new training mechanism which provides market-oriented and efficiency-focused personnel training. The mechanism of market competition has been introduced to our training work by gradually shifting from exclusive in-house training provided by the enterprise itself to market and society oriented training, in order to make full use of domestic and foreign training resources, reduce training costs, improve training quality and maximise the benefits of training. On February 10, 2001, it was announced at the training programme co-ordination meeting of the Company that from this year onwards, training programmes would gradually be arranged through open tender. The Company issued the Provisional Measures of

PetroChina Company Limited for the Administration of Tender Invitation and Bidding for Training Programmes on April 12, 2001, which expressly stipulates the principles and procedures to be adopted by the Company in its invitations for tenders and bids for training programmes. The Company held a training programme tender invitation and bidding conference on April 18, 2001, at which tenders were invited and bids were made for the first lot of seven training programmes in accordance with the principles of openness, equality, competition and merit. According to preliminary estimation, costs will be reduced by approximately 30%. There have been marked improvements in the design of the training programmes, qualifications of trainers and other areas.

## **Contingent Liabilities**

Information on the Group's contingent liabilities as of June 30, 2001 is as follows:

### **Bank and other guarantees**

As at June 30, 2001, the Group had contingent liabilities in respect of bank and other guarantees and other matters arising in the ordinary course of business from which it is anticipated that no material liabilities will arise.

### **Environmental liabilities**

CNPC and the Group have been operating in China for many years and certain environmental problems have developed. China has adopted extensive environmental laws and regulations that affect the operation of the oil and gas industry. The outcome of environmental liabilities under proposed or future environmental legislation cannot be estimated at present, but could be material. Under the existing legislation, however, the management believes that there are no probable environmental liabilities, except those amounts which have already been reflected in the financial statements, that will have a materially adverse effect on the financial position of the Group.

### **Legal contingencies**

The Group is the named defendant in certain insignificant lawsuits as well as the named party in certain other proceedings arising in the ordinary course of business. While the outcomes of such contingencies, lawsuits or other proceedings cannot be determined at present, the management believes that any resulting liabilities will not have a materially adverse effect on the financial position of the Group.

### **Leasing of roads, land and buildings**

According to the Restructuring Agreement entered into between the Company and CNPC, CNPC has undertaken to the Company the following:

CNPC will use its best endeavours to obtain formal land use right certificates to replace the entitlement certificates in relation to the 28,649 parcels of land which were leased or transferred to the Company from CNPC, within one year from August, September and October 1999 when the relevant entitlement certificates were issued. CNPC will complete, within one year from November 5, 1999, the necessary governmental procedures for the requisition of the collectively-owned land on which 116 service stations owned by the Company are located; and CNPC will obtain individual building ownership certificates in the name of the Company for all of the 57,482 buildings transferred to the Company by CNPC, before November 5, 2000.

Until now, CNPC has obtained some of the formal land use right certificates for the above-mentioned parcels of land, individual building ownership certificates for the above-mentioned buildings, and has completed none of the necessary governmental procedures for the above-mentioned service stations located on collectively-owned land. The Directors of the Company confirm that the use of and the conduct of relevant activities at the above-mentioned parcels of land, service stations and buildings are not affected by the fact that the relevant land use right certificates or individual building ownership certificates have not been obtained or the fact that the relevant governmental procedures have not been completed, and that these will not have a materially adverse effect on the results of operations or the financial position of the Group.

### **Group insurance**

Except for limited insurance coverage for vehicles and certain assets with significant operating risks, the Group does not carry any other insurance for property, facilities or equipment with respect to its business operations. In addition, the Group does not carry any third-party liability insurance against claims relating to personal injury, property and environmental damages or business interruption insurance since such insurance coverage is not customary in China. While the potential liability of under-insurance cannot be reasonably estimated at present, management believes it could have a materially impact on the operating results or financial position of the Group.

### **Cost reduction measures**

In addition to workforce reduction and shut-down of certain manufacturing facilities, the Company is currently evaluating options to further streamline production facilities and implement other cost reduction measures within the next several years to further improve the operating efficiency and competitiveness of the Group. The management has not approved all significant actions to be taken to complete the above plan. The management does not believe the plan will have a materially adverse impact on the Group's financial position, but certain cost reduction measures could have materially adverse effect on the Group's results of operations.

### **Prospects for the Second Half of 2001**

The Company had achieved encouraging results for the first half of 2001 despite the fact that crude oil prices have decreased compared with the same period last year. For the second half of 2001, the Company will actively adopt the following measures to increase its competitiveness and to create higher value for shareholders.

In relation to the exploration and production segment, the Company will actively increase its reserves and production capacity, including the acceleration and improvement of exploration activities mainly in the Junggar basin, Shaan-Gan-Ning basin and the southern SongLiao basin. There will also be an enhancement of crude oil production, an expansion of production facilities in new key areas and higher utilisation of reserves in lower cost efficiency areas using co-operative efforts.

The refining and marketing segment and the chemicals and marketing segment will strive to increase profitability. The refining and marketing segment will focus on increasing the light oil recovery rate, the composite commodity rate and the diesel-gasoline ratio, and to further improve various economic and technical indicators, and to increase the proportion of various refined products being sold through the Company's own operations. The chemicals and marketing segment will adjust and optimise its product mix according to market conditions, and will continue to adjust the utilisation rate of its facilities with a view to increasing marginal profits.

The natural gas and pipelines segment will actively strengthen its pipeline construction and market development activities. The Company expects to make further progress in the next few months in the selection of foreign investment partner(s) for the West-East gas pipeline project. The major pipeline construction work is expected to commence in the fourth quarter of this year. The Se-Ning-Lan pipeline is expected to be in full operation by the end of 2001. The construction of the Zhong-Han line is expected to commence in the second half of 2001. The Shaan-Jing pipeline network will be further developed. The principal work on the Lan-Cheng-Yu refined products pipeline is expected to be completed in the second half of this year, and the Company

aims to complete construction and commence production in the first quarter of next year. In the meantime, the Company will put extra emphasis on strengthening its market position. The Company will make full use of its resource rich position so as to build a stronger competitive edge in the markets.

In the coming few months, the Company will continue to adopt such measures as on-going restructuring, management optimisation, technology improvement, employee rationalisation and efficiency improvement so as to achieve our objective of cost reduction targets.

The Company will continue to evaluate various business development plans and the capital expenditures required. It will implement rigorous and prudent investment plans with an aim to increasing the rate of financial return on our investments.

The e-commerce website [www.energyahead.com](http://www.energyahead.com) of the Company was formally launched this July. As a neutral and collaborative e-commerce transaction platform for the oil and petrochemical industries, it offers a service to the energy industry both domestically and abroad. The Company believes that the launch of the e-commerce site provides it with better conditions for further improving corporate management, reducing purchasing costs, increasing economic benefits and promoting international operations. This platform serves as an effective way to comprehensively enhance corporate value and competitiveness.

Following the attainment of successful results in 2000, the Company remains committed to restructuring and to further reducing costs. In the meantime, there has been significant progress in the exploration for oil and gas. Moreover, the preliminary work on the West-East gas pipeline project is being carried out in a timely and systematic manner. The Company is confident that the operating results of this year will be maintained at impressively high levels.