MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Overview

For the twelve months ended December 31, 2001, profit before taxation of the Group was RMB69,458 million, representing a decrease of 15.35% compared with the corresponding period in the previous year. Net profit was RMB46,808 million, representing a decrease of 15.25% compared with the corresponding period in the previous year. The decrease in the Group's profitability is primarily attributed to the general decline in the prices of crude oil, refined products and chemical products as well as the decrease in the sales volume of crude oil. 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 twelve months ended December 31, 2001 were RMB0.27.

Twelve Months Ended December 31, 2001 Compared With Twelve Months Ended December 31, 2000

Consolidated Operating Results

Turnover Turnover decreased 1.28% from RMB241,992 million for the twelve months ended December 31, 2000 to RMB238,893 million for the twelve months ended December 31, 2001. This reflects the decrease in revenue of the exploration and production segment and the chemicals and marketing segment of the Group as a result of a decrease in the sales volume and decline in the average realised selling price of crude oil, and the decrease in the selling prices of petrochemical products.

Operating Expenses Operating expenses increased 6.68% from RMB156,233 million for the twelve months ended December 31, 2000 to RMB166,676 million for the twelve months ended December 31, 2001. This increase was due primarily to the increases in purchases, services and other expenses, selling, general and administrative expenses as well as taxes other than income taxes.

Purchases Services and Other Expenses Purchases, services and other expenses increased 22.78% from RMB62,598 million for the twelve months ended December 31, 2000 to RMB76,859 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in purchase of direct materials as a consequence of an increase in the sales volume of refined products.

Employee Separation Costs and Shut Down of Manufacturing Assets Employee separation costs and shut down of manufacturing assets decreased 92.73%. For the twelve months ended December 31, 2000, employee separation costs and shut down of manufacturing assets amounted to RMB6,579 million. The Company did not incur any costs for the shut down of manufacturing assets in the twelve months ended December 31, 2001, with the costs for this period comprising only employee separation costs of RMB478 million.

Employee Compensation Costs Employee compensation costs decreased 3.04% from RMB14,430 million for the twelve months ended December 31, 2000 to RMB13,992 million for the twelve months ended December 31, 2001. The decrease was due to the reduction in the number of employees which lowered the employee compensation costs.

Depreciation, Depletion and Amortisation Depreciation, depletion and amortisation decreased 1.16% from RMB33,760 million for the twelve months ended December 31, 2000 to RMB33,367 million for the twelve months ended December 31, 2001. The decrease was due primarily to the fact that oil-refining enterprises have disposed of a number of installations in 2000 resulting in a decrease in the base value of the provision for depreciation in 2001.

Selling, General and Administrative Expenses Selling, general and administrative expenses increased 25.15% from RMB16,649 million for the twelve months ended December 31, 2000 to RMB20,837 million for the twelve months ended December 31, 2001. The increase was due primarily to the higher transportation costs resulting from an increased sales volume in the refining and marketing segment, the expansion and extension of the sales and distribution network, and the expansion of external markets and changes in the marketing modes of the chemicals and marketing segment.

Taxes Other than Income Taxes Taxes other than income taxes increased 5.19% from RMB13,230 million for the twelve months ended December 31, 2000 to RMB13,916 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in consumption tax and other relevant taxes resulting from an increased sales volume in the refining and marketing segment.

Profit From Operations   Profit from operations decreased 15.79% from RMB85,759 million for the twelve months ended December 31, 2000 to RMB72,217 million for the twelve months ended December 31, 2001.

Net Exchange Gain Net exchange gain decreased 78.67% from RMB1,172 million for the twelve months ended December 31, 2000 to RMB250 million for the twelve months ended December 31, 2001. This decrease was due primarily to a substantial decrease in the balance of loans denominated in currencies which had been affected to a greater extent by fluctuations in exchange rates, such as the Japanese yen and Euro.

Net Interest Expense Net interest expense decreased 38.69% from RMB5,464 million for the twelve months ended December 31, 2000 to RMB3,350 million for the twelve months ended December 31, 2001. This decrease was due primarily to the Company's reinforcement of the centralisation of capital management and a decrease in the average balance of debts as well as a decrease in the average interest rate.

Profit Before Taxation Profit before taxation decreased 15.35% from RMB82,051 million for the twelve months ended December 31, 2000 to RMB69,458 million for the twelve months ended December 31, 2001.

Taxation Taxation decreased 14.57% from RMB26,985 million for the twelve months ended December 31, 2000 to RMB23,054 million for the twelve months ended December 31, 2001. This decrease was due primarily to a decrease in profit before taxation.

Net Profit Net profit decreased 15.25% from RMB55,231 million for the twelve months ended December 31, 2000 to RMB46,808 million for the twelve months ended December 31, 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 pipeline segment.

Exploration and Production

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

Sales and other operating revenue Sales and other operating revenue decreased

13.25% from RMB170,928 million for the twelve months ended December 31, 2000 to RMB148,277 million for the twelve months ended December 31, 2001. This decrease was due primarily to a decrease in our sales of 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, the decline in the international oil prices has resulted in a decrease of 13.23% in the average realised selling price of the Company's crude oil from US$27.21 per barrel as at December 31, 2000 to US$23.61 per barrel as at December 31, 2001.

Intersegment sales decreased 8.68% from RMB121,265 million for the twelve months ended December 31, 2000 to RMB110,738 million for the twelve months ended December 31, 2001. This decrease was due primarily to a decline in the price at which crude oil was sold to other business segments in 2001 as compared with 2000.

Operating Expenses Operating expenses decreased 5.86% from RMB75,785 million for the twelve months ended December 31, 2000 to RMB71,345 million for the twelve months ended December 31, 2001. This decrease was due primarily to the Company's persistent implementation of cost reduction measures resulting in decreases in purchases, services and other expenses and decreases in employee separation costs and exploration expenses.

Profit From Operations Profit from operations decreased 19.14% from RMB95,143 million for the twelve months ended December 31, 2000 to RMB76,932 million for the twelve months ended December 31, 2001.

Refining and Marketing

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

Sales and other operating revenue Sales and other operating revenue increased 5.20% from RMB161,148 million for the twelve months ended December 31, 2000 to RMB169,534 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the sales volume of principal products such as gasoline and diesel.

Sales revenue from gasoline increased 9.33% from RMB42,211 million for the twelve months ended December 31, 2000 to RMB46,151 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the sales volume of gasoline. The average realised selling price of gasoline decreased 5.75%, from RMB2,697 per ton for the twelve months ended December 31, 2000 to RMB2,542 per ton for the twelve months ended December 31, 2001.

Sales revenue from diesel increased 13.89% from RMB66,029 million for the twelve months ended December 31, 2000 to RMB75,202 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the sales volume. The average realised selling price of diesel decreased 3.75%, from RMB2,477 per ton in the twelve months ended December 31, 2000 to RMB2,384 per ton for the twelve months ended December 31, 2001.

Sales revenue from kerosene decreased 18.64% from RMB5,425 million for the twelve months ended December 31, 2000 to RMB4,414 million for the twelve months ended December 31, 2001. This decrease was due primarily to a decrease in the price and sales volume of kerosene.

Intersegment sales revenue increased 3.18% from RMB8,176 million for the twelve months ended December 31, 2000 to RMB8,436 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the sales volume to other segments.

Operating Expenses   Operating expenses increased 1.11% from RMB169,890 million for the twelve months ended December 31, 2000 to RMB171,780 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the output and sales volume of refined products.

Profit From Operations Profit from operations decreased from a loss of RMB8,742 million for the twelve months ended December 31, 2000 to a loss of RMB2,246 million for the twelve months ended December 31, 2001.

Chemicals and Marketing

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

Sales and other operating revenue   Sales and other operating revenue decreased 4.76% from RMB33,364 million for the twelve months ended December 31, 2000 to RMB31,776 million for the twelve months ended December 31, 2001. This decrease was due primarily to a decrease in the prices of principal chemical products as a result of the downturn in the market of chemical products, despite an increase in the sales volume of chemical products.

Operating Expenses Operating expenses increased 2.57% from RMB33,294 million for the twelve months ended December 31, 2000 to RMB34,150 million for the twelve months ended December 31, 2001. This increase resulted primarily from the increase in purchases, services and other expenses due to an increase in the sales volume and inventory-related changes. 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 from a gain of RMB70 million for the twelve months ended December 31, 2000 to a loss of RMB2,374 million for the twelve months ended December 31, 2001.

Natural Gas and Pipeline

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

Sales and other operating revenue Sales and other operating revenue increased 58.05% from RMB7,163 million for the twelve months ended December 31, 2000 to RMB11,321 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the selling price and sales volume of natural gas and the transfer of pipeline transmission business from the refining and marketing segment to the natural gas and pipeline segment. The sales volume of natural gas increased 13.09% from 391.0 billion cubic feet in the twelve months ended December 31, 2000 to 442.2 billion cubic feet in the twelve months ended December 31, 2001.

Operating Expenses   Operating expenses increased 48.26% from RMB7,149 million for the twelve months ended December 31, 2000 to RMB10,599 million for the twelve months ended December 31, 2001. This increase was due primarily to an increase in the sales volume of natural gas resulting in an increase in natural gas purchased and an increase 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 5,057.14% from RMB14 million for the twelve months ended December 31, 2000 to RMB722 million for the twelve months ended December 31, 2001.

Liquidity and Capital Resources

For the twelve months ended December 31, 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.

For the twelve months ended December 31, 2001, short-term debt comprised approximately 6% of our available capital employed as compared with approximately 12% for the twelve months ended December 31, 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, chemicals and marketing, and natural gas and pipeline segments.

We plan to fund the capital and related investments primarily with the cash generated by operating activities, short-term and long-term debts, and cash and cash equivalents. Net cash generated by operating activities for the twelve months ended December 31, 2001 was RMB84,492 million. For the twelve months ended December 31, 2001, we had cash and cash equivalents of RMB11,117 million. Cash and cash equivalents were primarily denominated in Renminbi (Renminbi accounting for approximately 98.81% and United States Dollar accounting for approximately 1.19%).

In the opinion of the management, our working capital is sufficient for meeting the present requirements for our investments and operations.

The table below sets forth our cash flows for each of the twelve months ended December 31, 2000 and 2001 and our cash equivalents at the end of each period.

	As at December 31,	
	2001	2000
	RMB million	RMB million
Net cash from operating activities	84,492	104,169
Net cash used for investing activities	(61,624)	(60,401)
Net cash used for financing activities	(29,811)	(43,556)
Cash and cash equivalents at the end of year	11,117	18,060

Cash Generated by Operating Activities

Our net cash generated by our operating activities decreased from RMB104,169 million for the twelve months ended December 31, 2000 to RMB84,492 million for the twelve months ended December 31, 2001. This decrease was due primarily to the decline in sales resulting from the decrease in the price of crude oil, refined products and petrochemical products, and to the increase in income tax payments made during the year. However, as we have continued to adopt the centralised management of debts and capital, we have achieved continuous decrease in interest payment and hence a reduction in cash outflow.

For the twelve months ended December 31, 2000, we had a working capital deficit of RMB12,967 million. For the twelve months ended December 31, 2001, we had a working capital deficit of RMB2,336 million. This deficit was due primarily to our ability or strategy to finance long-term projects with short-term loans at lower interest rates. We repaid a portion of our short-term liabilities with internally generated net cash flow in 2001, thereby reducing our working capital deficit.

Cash Provided by (or Used for) Financing Activities

Our net borrowings for the twelve months ended December 31, 2000 and for the twelve months ended December 31, 2001 were as follows:

Of the total debts of the Group as at December 31, 2001, approximately 39.56% were fixed-rate loans and 60.44% were floating-rate loans. Of the total debts as at December 31, 2001, approximately 79.50% were denominated in Renminbi, approximately 17.00% were

	December 31, 2001 RMB million	December 31, 2000 RMB million
Short-term borrowings (including current portion of long-term borrowings)	23,111	39,076
Long-term borrowings	65,484	53,341
Total borrowings	88,595	92,417
Less:		
Cash and cash equivalents	11,117	18,060
Time deposits with term exceeding three months	3,253	-
Receivables under resale agreements	11,505	5,815
Net debt	62,720	68,542

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

	Principal as at December 31, 2001 RMB million
To be repaid within one year	5,159
To be repaid within one to two years	6,197
To be repaid within two to five years	43,910
To be repaid after five years	15,377
	70,643

denominated in United States dollar, approximately 1.57% were denominated in British sterling, approximately 1.03% were denominated in Japanese yen and approximately 0.90% were denominated in Euro.

As at December 31, 2000 and December 31, 2001, the amount of short-term borrowings owed to related parties was RMB14,269 million and RMB1,268 million, respectively. As at December 31, 2000 and December 31, 2001, the amount of long-term borrowings owed to related parties were RMB9,652 million and RMB20,753 million, respectively.

As at December 31, 2001, our debts included short-term and long-term borrowings owed to China Petroleum Finance Company Limited of RMB1,268 million and RMB20,753 million, respectively.

Our net cash used for financing activities for the twelve months ended December 31, 2001 showed a decrease of 31.56% compared with the twelve months ended December 31, 2000. This decrease primarily resulted from the following:

- a decrease in the repayment of short-term loans leading to a decrease of RMB2,597 million in cash outflow;
- a decrease in the repayment of long-term loans leading to a decrease of RMB71,773 million in cash outflow;

- a distribution of RMB2,640 million was made to CNPC in 2000 whereas no such expenditure was incurred in 2001, leading to a decrease in cash outflow in the twelve months ended December 31, 2001.

Such increases were offset by the following:

- a decrease in new short-term loans leading to a decrease of RMB2,223 million in cash inflow;
- a decrease in new long-term loans leading to a decrease of RMB23,943 million in cash inflow;
- an increase in the payment of dividends leading to an increase of RMB16,318 million in cash outflow;
- new shares were issued in 2000 whereas no new shares were issued in 2001, leading to a decrease of RMB20,336 million in cash inflow in the twelve months ended December 31, 2001.

As at December 31, 2001, RMB284 million worth of loans made to the Group (RMB474 million in 2000) were secured loans (financing lease and bank loans). RMB58 million worth of the banks loans (RMB81 million in 2000) were secured by plant and equipment of the Group in the amount of RMB111 million (RMB179 million in 2000). Given that title to the leased property will be transferred to the lessor in the event of default, debts incurred by way of financing lease are in fact secured debts. As at December 31, 2001, the debts incurred by the Group by way of financing lease amounted to RMB226 million (RMB393 million in 2000). The net book value of the properties, plant and equipment under financing lease was RMB428 million (RMB607 million in 2000).

The debt to equity ratio (debt to equity ratio = interest-bearing debts/(interest-bearing debts + shareholder's equity)) as at December 31, 2001 was 23.21% (25.29% as at December 31, 2000).

Capital Expenditures

The table below sets forth our capital expenditures by business segment for each of the twelve months ended December 31, 2000 and December 31, 2001. Capital expenditures increased 2.37% from RMB59,762 million for the twelve months ended December 31, 2000 to RMB61,181 million for the twelve months ended December 31, 2001. The increase was due primarily to an increase in expenses in the first stage exploration for natural gas developments, increased efforts in ensuring safety, environmental protection and upgrading of existing oilfields, and increases in capital expenditures resulting from the commencement of the experimental phase of the West-East Gas Pipeline project and of the relevant controlling works.

	As at December 31,					
	2000		2001		2002 (estimated value)	
	RMB million	%	RMB million	%	RMB million	%
Exploration and production*	38,654	64.7	41,193	67.4	38,637	62.5
Refining and marketing	13,227	22.1	11,048	18.1	11,251	18.2
Chemicals and marketing	4,104	6.9	4,062	6.6	4,090	6.6
Natural gas and pipeline	3,214	5.4	4,557	7.4	7,392	11.9
Others	563	0.9	321	0.5	513	0.8
Total	59,762	100	61,181	100	61,883	100

*Note: If the investments relating to geological and geophysical exploration costs were included, the capital expenditures for the exploration and production segment for the years 2000 and 2001 and the estimated capital expenditures for 2002 would be RMB42,968 million, RMB45,115 million and RMB42,654 million, respectively.

Exploration and Production

The majority of our capital expenditures and investments relate to the exploration and production segment. Capital expenditures for exploration and production activities for the twelve months ended December 31, 2001 totalled RMB41,193 million, including RMB6,239 million for exploration activities and RMB29,444 million for development activities. Capital expenditures for the twelve months ended December 31, 2000 totalled RMB38,654 million, including RMB6,542 million for exploration activities and RMB27,765 million for development activities. The increase in our capital expenditures from the twelve months ended December 31, 2000 to the twelve months ended December 31, 2001 was due primarily to increases in expenses in the first stage exploration for natural gas developments, increased efforts in ensuring safety, environmental protection and upgrading of existing oilfields, and increases in reserves and output.

We anticipate that for the year ending December 31, 2002 capital expenditures for our exploration and production segment will amount to RMB38,637 million and capital expenditures and investments will amount to RMB42,654 million. Approximately RMB6,337 million is expected to be used for exploration activities and approximately RMB32,300 million for development activities. We plan to focus our natural gas exploration in Tarim Basin and our oil exploration in Ordos Basin, Junggar Basin and Songliao Basin.

Refining and Marketing

Capital expenditures for our refining and marketing segment for the twelve months ended December 31, 2001 totalled RMB11,048 million, of which RMB6,172 million was spent on the expansion of our refined product retail marketing network and storage infrastructure facilities, and RMB4,808 million was spent on the renovation of our refining facilities. Total capital expenditures for the twelve months ended December 31, 2000 were RMB13,227 million. The decrease in capital expenditures from the twelve months ended December 31, 2000 to the twelve months ended December 31, 2001 was due primarily to the relative decrease of capital expenditures by the Company in expanding the retail network of refined products in 2001.

We anticipate that capital expenditures and investments for our refining and marketing segment for the year ending December 31, 2002 will amount to RMB11,251 million, which include:

- approximately RMB6,300 million for the construction and expansion of refining facilities; and
- approximately RMB4,951 million for investments in our refined product sales 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 twelve months ended December 31, 2001 decreased 1.02% from RMB4,104 million for the twelve months ended December 31, 2000 to RMB4,062 million for the twelve months ended December 31, 2001. The decrease in capital expenditures was due primarily to our adoption of a more rigorous return-based evaluation system, leading to a stricter control over and a decrease in capital expenditures for the chemicals segment.

We anticipate that capital expenditures and investments for our chemicals and marketing segment for the year ending December 31, 2002 will amount to RMB4,090 million, which include the expenditures for expanding the capacity and transforming the Daqing petrochemical ethylene installations.

Natural Gas and Pipeline

Capital expenditures for our natural gas and pipeline segment for the twelve months ended December 31, 2001 totalled RMB4,557 million, of which RMB4,415 million was spent on the construction of long distance pipeline and RMB1,254 million was spent on the West-East Gas Pipeline project. Capital expenditures for the twelve months ended December 31, 2000 totalled RMB3,214 million. The increase in our capital expenditures from the twelve months ended December 31, 2000 to the twelve months ended December 31, 2001 was due primarily to the substantial progress made in the initial preparation phase for the West-East Gas Pipeline project, and an increase in capital expenditures resulting from the commencement of the experimental phase of the West-East Gas Pipeline project and of the relevant controlling works.

We anticipate that capital expenditures and investments for our natural gas and pipeline segment for the year ending December 31, 2002 will amount to RMB7,392 million. Approximately RMB6,051 million is expected to be invested in the West-East Gas Pipeline project and the Zhong-Wu and Lan-Cheng-Yu natural gas pipeline. We currently expect that approximately RMB508 million will be invested in the natural gas storage infrastructure projects and other natural gas pipeline, and approximately RMB833 million will be invested in the pipeline for the transmission of crude oil and refined product.

Others

Our non-segment-specific capital expenditures for the twelve months ended December 31, 2000 and December 31, 2001 were RMB563 million and RMB321 million, respectively. Our non-segment-specific capital expenditures related primarily to 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, 2002 will amount to RMB513 million, which will be used primarily for the construction of water and electricity supply systems, and roads and telecommunications systems to be used by various segments.

Material Investment

The West-East Gas Pipeline project is the largest project undertaken by the Company since the Company's listing. The commencement of the construction of the West-East Gas Pipeline has important strategic meaning in the context of securing the Company's leading position in the domestic natural gas market, turning the Company's advantage in resources into benefits, and making the natural gas business a new source of increased profitability for the Company. At the same time, the project will benefit the progress of economic development of the western regions of the PRC, in particular the Xinjiang region, improve the energy structure in the natural gas consumption regions, improve the atmospheric environment, and improve the general living standards.

The West-East Gas Pipeline project has achieved a progressive step in the process of selecting international participants. Among the short-listed group of international investment consortia, the Company chose to firstly engage in negotiations with the Shell Investment Consortium. After repeated negotiations, the Company and the Shell Investment Consortium, comprising Shell International Gas Limited, OAO Gazprom, OAO Stroytransgaz and Hong Kong China Gas Company Limited, reached consensus on the principles for the project and entered into the "Interim Agreement on basis for Finalisation of West to East Gas Pipeline Joint Venture Framework Agreement" on December 29, 2001. The major issues covered by the agreement are: (1) upstream oil and gas exploration production shall adopt the production sharing contract model; a pipeline joint venture in the form of a co-operative joint venture shall be established; a unified sales company for natural gas in the form of an equity joint venture shall be established; (2) the shareholding interests in the pipeline joint venture, the unified sales company and the participating interests in the production sharing contracts for the Tarim Basin which will supply natural gas into the pipeline will be 55% and 45% for the Chinese party and the foreign party, respectively; (3) the terms of each of the pipeline joint venture and the unified sales company will be 45 years; (4) the commercial operation model of the unified sales company was agreed upon; and (5) with respect to health, safety, environmental and social standards, all parties shall comply with Chinese laws and all parties agree to adopt and apply the specifications and standards agreed to by the parties. On the above basis, the Company is currently engaged in the drafting and negotiation work of the ìWest to East Pipeline Joint Venture Framework Agreementî with the Shell Investment Consortium.

The Project will adopt an internationally accepted organisational and management structure: bidding process for the purchase of vast amount of raw materials required for construction has commenced through the internet; the construction teams have been selected through a stringent bidding process; and the Project will adopt a third party supervising system to manage the quality of construction.

The overall construction plan of the pipeline is: to commence full construction in the first half of 2002; to complete and commence operation in the Jingbian-Shanghai section in early 2004 and to commence the supply of natural gas towards the direction of Shanghai; and to complete and commence operation in the Lunnan-Jingbian section by the first half of 2005 so as to achieve full operation and to transmit gas from the Tarim Basin to Shanghai, the Changjiang Delta region and the relevant provinces and cities along the pipeline.

Major Acquisition and Disposal

The Group did not have any major acquisition or disposal in the year ended December 31, 2001.

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 December 31, 2000 and December 31, 2001, we had 441,612 and 422,554 employees, respectively. The table below sets forth the number of our employees by business segment as at December 31, 2001:

	Number of Employees	% of total
Exploration and production	230,637	54.58
Refining and marketing	112,938	26.73
Chemicals and marketing	66,264	15.68
Natural gas and pipeline	10,309	2.44
Others*	2,406	0.57
Total	422,554	100

* Note: Including research and development, planning and headquarters management

Remuneration

The total remuneration payable by the Company for the twelve months ended December 31, 2001 was RMB9,244 million, being the total monthly salaries of our employees during the 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 remuneration system links senior management members' financial interests (including those of our executive directors and our supervisors) with the Company'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 0% 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 profit, 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	30	70	0
President	25	60	15
Vice President	25	60	15
Department General Manager	25	50	25

Details of the directors' and supervisors' emoluments for the twelve months ended December 31, 2000 and the twelve months ended December 31, 2001 are as follows:

	Twelve months ended December 31,	
	2001	2000
	RMB thousand	RMB thousand
Fee for directors and supervisors	170	140
Salaries, allowances and other benefits	1,104	972
Contribution to retirement benefit scheme	23	27
	1,297	1,139

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

	Twelve months ended December 31,	
	2001	2000
	Number of persons	Numberof persons
Nil — RMB1,000,000	12	12

Employee Separation Plan

For the twelve months ended December 31, 2001, 19,800 employees were dismissed with compensation by the Company. The actual expenditure for such reduction amounted to RMB1,513 million. Of these employees, 13,900 employees were dismissed under the employee separation plan for 2000, and the expense for such plan in the amount of RMB1,035 million was provided for in 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 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 2001 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 on a trial basis 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 December 31, 2001 are as follows:

Bank and other guarantees

As at December 31, 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 operated 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, and 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 of August, September and October 1999 when the relevant entitlement certificates were issued; CNPC will complete, within one year of 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.

As at December 31, 2001, CNPC has obtained formal land use right certificates for 12,417 of the 28,649 parcels of land aforesaid and some of the building ownership certificates, but has not yet completed the procedures required for the requisition of the collectively-owned land on which the service stations are located. The Directors of the Company believe that the use of and the conduct of relevant activities at the 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 commercial 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, the Group's management believes it may have a material impact on the operating results or financial position of the Group.

Cost reduction measures

The Company anticipates that the cost reduction target which was set during the initial public offering will be achieved in 2002. In addition to employee separation plan and shut down of certain manufacturing assets, 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 competitiveness and operating efficiency of the Company. The management of the Company has not yet approved all significant actions to be taken to achieve these measures. The management does not believe the plan will have any material adverse impact on the Group's financial position, however, certain cost reduction measures could have materially adverse effect on the Group's current profit and loss.