

BUSINESS OPERATING REVIEW

The Company was established as a joint stock limited company with limited liability under the Company Law of the PRC on November 5, 1999 as part of the restructuring of CNPC. In the restructuring, CNPC injected into the Company most of the assets, liabilities and interests of CNPC relating to its exploration and production, refining and marketing, chemicals and natural gas businesses. The ADSs and H shares of the Company were listed on The New York Stock Exchange and The Hong Kong Stock Exchange Limited on April 6, 2000 and April 7, 2000 respectively.

The Company is engaged in a broad range of petroleum-related activities, including:

- the exploration, development and production and sale of crude oil and natural gas;
- the refining, transportation, storage and marketing of crude oil and petroleum products;
- the production and sale of basic petrochemical products, derivative chemical products, and other chemical products; and
- the transmission of natural gas and crude oil, and the sale of natural gas.

The Company is China's largest producer of crude oil and natural gas and one of the largest companies in China in terms of sale. Currently all of the Company's petroleum and natural gas reserves and production related assets are located in China.

Exploration and Production

For the twelve months ended December 31, 2001, the Company's annual total output of oil and gas amounted to 857.4 million barrels, including 763.5 million barrels of crude oil and 563.5 billion cubic feet of marketable natural gas, representing an average production of 2.09 million barrels of crude oil and 1.544 billion cubic feet of marketable natural gas per day. The Company sold 716 million barrels of crude oil and 529.8 billion cubic feet of natural gas. Approximately 75% of the crude oil sold by the Company was purchased by the refineries of the Company. For the twelve months ended December 31, 2001, the Company successfully reduced its lifting cost to US\$4.376 per barrel, representing a decrease of 6.6% in comparison with the twelve months ended December 31, 2000. By December 31, 2001, the exploration and production segment achieved 75% of the RMB6 billion cost reduction target set for the four years up to end of 2002.

Refining and Marketing

For the twelve months ended December 31, 2001, the Company's refineries processed 567 million barrels of crude oil, or an average of 1.55 million barrels per day. Approximately 95% of the crude oil, processed in the Company's refineries was supplied by the exploration and production segment. The Company produced approximately 46.54 million tons of gasoline, diesel and kerosene and sold approximately 51.64 million tons of these products. The Company is actively expanding its sales and distribution networks, in particular the retail distribution network, by capitalising fully on the complementary value-added effect of the integration of refining and marketing. As at December 31, 2001, there were 12,102 service stations either owned, controlled or franchised by the Company or owned by CNPC but to which the Company provides supervisory support. As at December 31, 2001, the Company owned and operated a crude oil pipeline network of approximately 9,186 kilometres and a refined product pipeline of 984 kilometres. The processing costs of the refining unit of the Company are also declining steadily, from RMB141 per ton to RMB138 per ton. By December 31, 2001, the refining and marketing segment achieved 89% of the RMB1.3 billion cost reduction target set for the four years up to 2002.

Chemicals and Marketing

For the twelve months ended December 31, 2001, the Company produced approximately 1.571 million tons of ethylene, 1.827 million tons of synthetic resin, 0.327 million tons of synthetic fibres, 0.239 million tons of synthetic rubber, and 3.068 million tons of urea. Up to December 31, 2001, the chemicals and marketing segment had reduced costs by 88% of the RMB 1.2 billion cost reduction target set for the four years up to end of 2002.

Natural Gas and Pipeline

The natural gas and pipeline segment is the Company's core business segment for further development. For the twelve months ended December 31, 2001, the Company produced 563.5 billion cubic feet of marketable natural gas, of which 442.2 billion cubic feet was sold through the natural gas and pipeline segment. The Company currently owns and operates 12,918 kilometres of regional natural gas pipeline networks, of which 11,826 kilometres are operated by the natural gas and pipeline segment.

The West-East Gas Pipeline project is progressing well. Details of the project are set out in the section headed "Management's Discussion and Analysis of Financial Condition and Results of Operations - Material Investment" above.