Outlook

The global political situation remains turbulent in 2003, and investors are further cautious given the shadow of war in the Middle East, making a strong global economic growth become merely a wish. Although the international oil price level in the long-term is dependent on the fundamentals of the global economy, political and economic outbursts will definitely impact the oil price, resulting in adverse effects on the Company's development. However, as the Company mainly operates in countries in Asia Pacific, such as China and Indonesia, the political stability and economic dynamism within the region will provide the necessary opportunities for the Company to gear up its development. Meanwhile, the management will continue to remain highly alert to the Company's business environment, and will face the difficulties on the grounds of prudence and progressiveness.

After the historic production growth in 2002, the Company will consolidate and strengthen its management in 2003 to prepare for further expansions in the future. We will focus on growing our production on a low-cost basis, and adding quality reserves through explorations and opportunistic acquisitions. As a crucial component in the Company's continual growth, natural gas projects will continue to play an important role in the Company's future development.

In 2003, two oil and gas fields in coastal China will commence production, allowing the Company to achieve its pre-set production target.

Given that the Company's balanced asset portfolios, progressive and enthusiastic management team, prudent financial policies and healthy financial position have already laid a solid foundation for our production and development, the management expresses optimism over the business prospects in 2003.

Consolidated Net Profit

Our consolidated net income after tax was RMB9,232.8 million (US$1,115.1 million) in 2002, an increase of RMB1,275.2 million (US$154.0 million), or 16.0%, from RMB7,957.6 million in 2001.

Revenue

Our oil and gas sales for the year 2002 were RMB 23,779.3 million (US$2,871.9 million), an increase of RMB6,218.5 milion (US$751.0 milion), or 35.4%, from RMB17,560.8 million in the year 2001. The increase primarily reflects the rise in our production level, as well as the increase in global crude oil prices during 2002. Of the increase in oil and gas sales, RMB5,417.0 million (US$654.2 million) was attributable to our increased production volume, while RMB801.5 million (US$96.8 million) was attributable to the rise in crude oil prices. In 2002, as a result of the commencement of production in our new oil and gas properties as well as our successful acquisition of overseas oil and gas properties, our production volume increased significantly compared to 2001. Our net production level in 2002 increased by 33% compared to the same period last year, one of the highest growth years in our history. The net crude oil and condensate production volume per day was 298,625 barrels in 2002, compared to 228,874 barrels in 2001, an increase of 69,751 barrels, or 30.5%. Our Indonesian oil and gas operations accounted for 15% of our increase in production volume. Production volume increases offshore China primarily resulted from the commencement of operations in our new oil and gas properties, including new platforms in Suizhong 36-1 (Phase II), Qinhuangdao 32-6, Wenchang 13-1 and Wenchang 13-2. Our daily average production for natural gas in 2002 was 272.6 million cubic feet, an increase of 77.6 million cubic feet, or 39.8%, from 195.0 million cubic feet in 2001. The increase was primarily attributable to our Indonesian operations. Our crude oil sales prices are determined in accordance with international crude oil prices. The average realised price for our crude oil was US$24.35 per barrel in 2002, an increase of

US$1.01, or 4.3%, compared to US$23.34 per barrel in 2001. The average realised price of natural gas was US$2.98 per thousand cubic feet in 2002, a decrease of US$0.10, or 3.2%, from US$3.08 per thousand cubic feet in 2001. The decrease was due to the lower natural gas price of our Indonesian properties relative to prices in China.

Our marketing revenues in 2002 were RMB2,377.5 million (US$287.1 million), a decrease of RMB159.5 million (US$19.3 million), or 6.3%, from RMB2,537.0 million in 2001.

Our other income, reported on a net basis in 2002, was RMB217.1 million (US$26.2 million) and consisted primarily of project management and handling fees. This was at a similar level to 2001. In 2001, our other income on a net basis was RMB203.8 million, which was derived from our other income of RMB721.7 million less corresponding costs of RMB517.9 million in other expenses.

Expenses

Operating expenses

Our operating expenses were RMB3,775.3 million (US$456.0 million) in 2002, an increase of RMB1,446.2 million (US$174.7 million), or 62.1%, from RMB2,329.1 million in 2001. The increase primarily resulted from operating expenses in connection with the Indonesian oil and gas properties and the commencement of operations in new properties offshore China. The operating expenses for the Indonesian oil and gas properties were RMB1,237.8 million (US$149.5 million) in 2002. On a unit of production basis, operating expenses were RMB30.3 (US$3.66) per BOE in 2002, which were higher than operating expenses of RMB24.9 (US$3.01) per BOE in 2001. The increase was largely attributable to the higher operating expenses on a unit of production basis for the Indonesian oil and gas properties, resulting from the different fiscal regime applicable to Indonesia. Our operating expenses excluding Indonesia in 2002 were RMB23.6 (US$2.85) per BOE.

Production taxes

Our production taxes for the year 2002 were RMB1,023.0 million (US$123.6 million), an increase of 15.8%, or RMB139.2 million (US$16.8 million) from RMB883.8 million in 2001. The increase was due to increase in oil and gas sales in 2002.

Exploration costs

Our exploration costs for the year 2002 were RMB1,318.3 million (US$159.2 million), an increase of RMB279.0 million (US$33.7 million), or 26.8%, from RMB1,039.3 million in 2001. The increase primarily resulted from a higher volume of exploration activities.

Depreciation, depletion and amortisation expenses

Our depreciation, depletion and amortisation expenses for 2002 were RMB4,019.5 million (US$485.4 million), an increase of RMB1,452.6 million (US$175.4 million), or 56.6%, from RMB2,566.9 million in 2001. On a unit of production basis, depreciation, depletion and amortisation expenses for the year 2002 were RMB32.3 (US$3.90) per BOE, an increase of 17.5% compared to RMB27.5 (US$3.32) per BOE in 2001. The primary reason for the increase was the newly acquired Indonesian oil and gas properties, and the commencement of production at new oil and gas properties offshore China.

Dismantlement

Our dismantlement costs for the year 2002 was RMB126.1 million (US$15.2 million), an increase of RMB35.7 million (US$4.3 million), or 39.5%, from RMB90.4 million in 2001. The increase was primarily due to an upward revision of the estimated dismantlement costs and the commencement of production at new oil and gas properties offshore China.

Impairment losses

There were no impairment losses related to oil and gas properties in 2002.

Crude oil and product purchase

Our crude oil and product purchases for the year 2002 were RMB2,326.3 million (US$281.0 million), a decrease of RMB127.0 million (US$15.3 million), or 5.2%, from RMB2,453.3 million in 2001. We handle crude oil sales in China for our foreign partners. Upon their request, we purchase their share of crude oil for resale in China, since we are one of the only three companies authorised to market and sell crude oil in the PRC. We do not have control over our foreign partners' decisions regarding the sale of their share of production, and therefore have no control over the volume that we may be asked to handle in any particular period.

Selling and administrative expenses

Our selling and administrative expenses for the year 2002 were RMB1,006.5 million (US$121.6 million), an increase of RMB391.1 million (US$47.2 million), or 63.6%, from RMB615.4 million in 2001. On a unit of production basis, selling and administrative expenses were RMB8.1 (US$0.98) per BOE in 2002, an increase of 22.7% from RMB6.6 (US$0.80) per BOE in 2001. The primary reason for the increase was the RMB272.1 million (US$32.9 million) selling and administrative expenses incurred in connection with the acquisition of Indonesian oil and gas properties and the commencement of production at the new oil and gas properties offshore China. Our selling and administrative expenses excluding Indonesia in 2002 were RMB6.82 (US$0.82) per BOE.

Net interest expense/income

Our net interest expense for 2002 was RMB146.9 million (US$17.7 million), an increase of RMB348.0 million (US$42.0 million) from a net interest income of RMB201.1 million in 2001. This increase was primarily due to interest expense associated with US$500 million long-term guaranteed notes in 2002, which led to an increase in interest expense of RMB135.0 million (US$16.3 million) record in the income statement. Further, the net interest expenses recognised under SSAP 28, which we adopted in 2002, relating to provision for dismantlement was RMB77.9 million (US$9.4 million).

Exchange Gain/Loss, net

Our exchange loss for 2002 was RMB113.8 million (US$13.7 million) compared with an exchange gain of RMB235.4 million in 2001. The decrease was partly attributable to exchange rate fluctuations related to our yen-denominated loans in 2002. On 27 December, 2002, we prepaid a sum of JPY21,162 million in yen-denominated loans, after which our outstanding yen-denominated loans were JPY1,357 million. Since the outstanding amount of our yen-denominated loans is hedged using foreign currency swaps, we do not expect similar exchange gains or losses in the future.

Investment Income

Our investment income for 2002 was RMB193.3 million (US$23.3 million), a decrease of RMB27.4 million (US$3.3 million) or 12.4% from RMB220.7 million in 2001. The decrease was primarily due to a decline in short-term interest rates in 2002.

Share of profit of an associate

Our share of profit of an associate for the year 2002 was RMB165.4 million (US$20.0 million), an increase of RMB75.4 million (US$9.1 million), or 83.8%, from RMB90.0 million in 2001. This item reflected our share of profit generated by Shanghai Petroleum and Natural Gas Company Limited, our associated company. This company experienced a decrease in its amortisation cost resulting from an increase in exploitable reserves.

Non-operating loss/income, net

Our non-operating loss for the year 2002 was RMB71.4 million (US$8.6 million), a decrease of RMB106.3 million (US$12.8 million) from non-operating profit of RMB34.9 million in 2001, primarily due to the losses incurred in the disposal of certain assets in 2002.

Tax

Our taxation for the year 2002 was RMB3,541.4 million (US$427.7 million), an increase of RMB493.2 million (US$59.6 million) or 16.2% from RMB3,048.2 million in 2001. The primary reason for the increase was the increase in profit before tax. The effective tax rate for both 2002 and 2001 was 27.7%.

Cash generated from operations

Cash generated from operations in 2002 amounted to RMB17,262.0 million (US$2,084.8 million), an increase of RMB3,237.0 million (US$390.9 million), or 23.1%, from RMB14,025.0 million in 2001. In addition to an increase in profit before tax of RMB1,768.4 million (US$213.6 million), the increase in cash generated from operations was also due in part to an increase in net interest expenses of RMB348.0 million (US$42.0 million), an increase in net exchange loss of RMB375.1 million (US$45.3 million), an increase in depreciation, depletion and amortisation expenses of RMB1,452.6 million (US$175.4 million), an increase in dismantlement costs of RMB35.7 million (US$4.3 million) and a decrease in short-term investment income and amortisation of discount of long-term guaranteed notes of RMB33.5 million (US$4.0 million).

The increase was partially offset by our share income of an associate RMB75.4 million (US$9.1 million) growth, a decrease in provision for impairment of property, plant and equipment of RMB99.7 million (US$12.0 million) and a decrease in loss on disposals and write off of property, plant and equipment of RMB19.0 million (US$2.3 million).

In addition, operating cash flow was adversely affected by an increase in current liabilities from operating activities of RMB500.8 million (US$60.5 million), and a simultaneous increase in current assets excluding cash and bank balances of RMB504.7 million (US$61.0 million).

Capital Expenditures and Investments

In line with our use of the successful efforts method of accounting, total capital expenditures and investments primarily include successful exploration and development expenditures. Total capital expenditures were RMB11,566.9 million (US$1,397.0 million) in 2002, an increase of RMB7,224.3 million (US$872.5 million), or 166.4%, from RMB4,342.6 million in 2001. The capital expenditure in 2002 included RMB585.6 million (US$70.7 million) for capitalised exploration activities, RMB6,247.1 million (US$754.5 million) for development activities, and RMB4,734.2 million (US$571.8 million) for acquiring Indonesian oil and gas properties. Our development expenditures in 2002 related principally to the development of Suizhong 36-1 (Phase II), Qinhuangdao 32-6, Wenchang 13-1, Wenchang 13-2, Penglai 19-3 and Panyu 4-2/5-1.

Financing Activities

We had net cash outflows from financing activities of RMB1,428.1 million (US$172.5 million) in 2002, resulting primarily from our repayment of RMB3,367.3 million (US$406.7 million) in bank loans and dividend distributions of RMB2,265.1 million (US$273.6 million). This cash outflow was offset by cash inflow of RMB4,059.3 million (US$490.3 million) resulting from our March 2002 offering of US$500 million in 6.375% guaranteed notes due 2012.

The following table summarises the maturities of our long-term debt outstanding as of 31 December 2002.

	Debt maturities principal only				
		Original currency		Total RMB	Total US$
Due by 31 December,	US$	JPY	RMB	equivalents	equivalents
	(in millions, except percentages)				
2003	31.4	271.5	18.9	297.5	35.9
2004-2006	100.0	814.4	38.4	922.4	111.4
2007-2008	-	271.5	-	18.7	2.3
2009 and beyond	500.0	-	-	4,140.0	500.0
Total	631.4	1,357.4	57.3	5,378.6	649.6
Percentage of total debt	97.2%	1.7%	1.1%	100.0%	100.0%

Market Risks

Our market risk exposures primarily consists of fluctuations in oil and gas prices, exchange rates and interest rates.

Commodity price risk: We are exposed to fluctuations in prices of crude oil and natural gas, which are commodities whose prices are determined by reference to international market prices. International oil and gas prices are volatile and this volatility has a significant effect on our net sales and net income. We do not hedge market risk resulting from fluctuations in oil and gas prices.

Currency risk: Our foreign exchange exposure gives rise to market risk associated with exchange rate movements.

Substantially all of our oil and gas sales are denominated in Renminbi and U.S. dollars. In the last nine years, the PRC government's policy of maintaining a stable exchange rate and China's ample foreign reserves have contributed to the stable of the Renminbi. Our domestic oil and gas prices are quoted in U.S. dollars based on international U.S. dollar oil prices we are therefore naturally able to offset Renminbi exchange rate risk. Our major foreign currency risk arises from our Japanese yen-denominated loans. We manage our yen-denominated loans in response to market changes.

In early 2002, the yen depreciated sharply against the U.S. dollar. At the time, a majority of our yen-denominated loans was still outstanding. However, because we and our auditors at that time, Arthur Andersen, were concerned about US GAAP FAS 133's disclosure risk in respect of structured swaps, we missed an opportunity to take advantage of the depreciation in the yen. In December 2002, we prepaid JPY21,162 million in yen-denominated loans. Currently, since the outstanding amount of our yen loans is hedged against foreign currency swaps, we do not expect similar exchange gains or losses in the future.

Interest rate risk: On 1 January 2002, our floating rate foreign currency debt was US$142.3 million. On 31 December 2002, that figure had fallen to US$31.4 million, accounting for 4.9% of total foreign currency denominated debt. On 1 January 2002, our fixed rate foreign currency debt was US$311.0 million. As a result of our offering of US$500 million guaranteed notes in 2002, our fixed rate foreign currency debt rose to US$603.0 million by 31 December 2002, accounting for 93.8% of our total foreign currency denominated debt. On 3 January 2003, we repaid our outstanding floating rate foreign currency debt. Therefore all of our foreign currency debt is fixed rate debt. We think our projects can afford the interest expenses despite the market interest rate dropped obviously in last year.

Significant Investments

We had a strategy to make strategic investments in related natural gas business. In September 2002, we entered into an agreement with BP to acquire a 12.5% interest in the Tangguh LNG Project in Indonesia for approximately US$275 million. In October 2002, we entered into an agreement with the North West Shelf Venture partners to acquire an interest of up to 5.56% in the Australian North West Shelf Gas Project titles and to assume a 25% interest in a LNG joint venture to be established. The acquisition of the interest in the Tangguh Project was completed in February 2003 and effective as of 1 January 2003. In March 2003, we entered into an agreement with BG International Limited to acquire an 8.33% interest in the North Caspian Sea Project in Kazakhstan for US$615 million, subject to certain adjustments. Completion of the acquisition is subject to the satisfaction of a number of conditions including the waiver of certain pre-emption rights by the existing partners and receipt of govermental approvals.

Material Acquisitions

During the financial year ended 31 December 2002, we acquired nine subsidiaries of Repsol YPF, S.A. which held a portfolio of operated and non-operated interests in oil and gas production sharing and technical assistance contracts in contract areas located offshore and onshore Indonesia. The aggregate consideration for the acquisition was a net cash consideration of US$566 million after adjustments.

Employees

We have 2,047 employees at the end of 2002. With a view to ensuring that our compensation packages are competitive in the industry and our employees are motivated to perform well in their jobs, we have adopted a flexible and efficient human resources policy.

We have adopted three stock option schemes for our senior management since 4 February 2001 and granted options under each of the schemes. In 2002, we have improved our human resources management system by establishing through the Internet an employee performance evaluation system and a recruitment system. We focused on customized and effective training for our employees and conducted 388 training courses in various areas in 2002, which were attended by more than 8,482 participants.