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 interim report.

Overview

For the six months ended June 30, 2003, profit before taxation of the Group was RMB54,116 million, representing an increase of 86.42% compared with the corresponding period last year. Net profit was RMB38,619 million, representing an increase of 102.45% compared with the corresponding period last year. The increase in the Group's profitability was due primarily to increases in prices and the sales volume of principal products such as crude oil, gasoline and diesel. 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, 2003 were RMB0.22.

Consolidated Operating Results

Turnover Turnover increased 36.82% from RMB108,143 million for the six months ended June 30, 2002 to RMB147,960 million for the six months ended June 30, 2003. This was due primarily to the increase in the selling prices and the sales volume of the Group's principal products such as crude oil, gasoline and diesel.

Operating Expenses Operating expenses increased 20.46% from RMB77,172 million for the six months ended June 30, 2002 to RMB92,965 million for the six months ended June 30, 2003. This was due primarily to the increased expenses in purchases, services and other expenses and the increased depreciation, depletion and amortisation.

Purchases, Services and Other Expenses Purchases, services and other expenses increased 30.88% from RMB30,918 million for the six months ended June 30, 2002 to RMB40,465 million for the six months ended June 30, 2003. This mainly reflects the increased purchase expenses for refining operations resulting from higher crude oil prices and the increased chemicals purchase expenses resulting from the increased raw chemical material prices.

Employee Compensation Costs Employee compensation costs increased 19.18% from RMB6,943 million for the six months ended June 30, 2002 to RMB8,275 million for the six months ended June 30, 2003. The increase was due primarily to an increase in employees' wages and bonuses corresponding to better operating results of the Company in the first half of this year and an increase in employee compensation costs as a result of the development of retail business in marketing.

Depreciation, Depletion and Amortisation Depreciation, depletion and amortisation increased 10.23% from RMB18,968 million for the six months ended June 30, 2002 to RMB20,909 million for the six months ended June 30, 2003. This increase was due primarily to the higher impairment of assets and increase in current depreciation, depletion and amortisation expenses resulting from an increase in the newly added plant and equipment.

Selling, General and Administrative Expenses Selling, general and administrative expenses increased 12.00% from RMB9,905 million for the six months ended June 30, 2002 to RMB11,094 million for the six months ended June 30, 2003. This increase was due primarily to the higher impairment of receivables.

Taxes Other than Income Taxes Taxes other than income taxes increased 10.70% from RMB7,111 million for the six months ended June 30, 2002 to RMB7,872 million for the six months ended June 30, 2003. This increase was due primarily to an increase in the production of gasoline and diesel products resulting in higher consumption tax; an increase in income resulting in higher resources compensation fee; and an increase in circulation tax resulting in corresponding increases in the urban construction tax and the surcharges for education.

Profit From Operations Profit from operations increased 77.57% from RMB30,971 million for the six months ended June 30, 2002 to RMB54,995 million for the six months ended June 30, 2003.

Net Exchange Gain (Loss) Net exchange loss decreased from a net loss of RMB239 million for the six months ended June 30, 2002 to a net loss of RMB64 million for the six months ended June 30, 2003. This decrease was due primarily to a decrease in foreign exchange borrowing balances in the first half of 2003 compared with the same period last year, and the increase in foreign exchange rates, such as British Sterling, Japanese Yen and Euro, in the first half of 2003 has diminished compared with the increase in the first half of 2002, resulting in decreased foreign exchange losses in respect of foreign currency borrowings.

Net Interest Expense Net interest expense decreased 37.89% from RMB1,808 million for the six months ended June 30, 2002 to RMB1,123 million for the six months ended June 30, 2003. This decrease was due primarily to a decrease in the average balance of debts and decreases in the average borrowing interest rates in the first half of 2003.

Profit Before Taxation Profit before taxation increased 86.42% from RMB29,029 million for the six months ended June 30, 2002 to RMB54,116 million for the six months ended June 30, 2003.

Taxation Taxation increased 53.51% from RMB9,902 million for the six months ended June 30, 2002 to RMB15,201 million for the six months ended June 30, 2003 due primarily to an increase in profit before taxation.

Net Profit Net profit increased 102.45% from RMB19,076 million for the six months ended June 30, 2002 to RMB38,619 million for the six months ended June 30, 2003.

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.

Turnover Turnover increased 37.09% from RMB66,732 million for the six months ended June 30, 2002 to RMB91,485 million for the six months ended June 30, 2003. This increase was due primarily to a significant increase in the average realised selling price of our crude oil and the increased sales volume of natural gas. As the Company's oil prices are directly linked to the international oil prices, increases in the international oil prices have therefore caused an increase of 39.63% in the Company's average realised selling price of crude oil, from US$20.11 per barrel for the six months ended June 30, 2002 to US$28.08 per barrel for the six months ended June 30, 2003.

Intersegment sales increased 35.53% from RMB48,486 million for the six months ended June 30, 2002 to RMB65,714 million for the six months ended June 30, 2003. This increase was due primarily to an increase in the price of crude oil sold to the other business segments and the increased sales volume of natural gas.

Operating Expenses Operating expenses increased 11.07% from RMB37,107 million for the six months ended June 30, 2002 to RMB41,215 million for the six months ended June 30, 2003 due primarily to an increase in exploration expenses and impairment of receivables.

Profit From Operations Profit from operations increased 69.69% from RMB29,625 million for the six months ended June 30, 2002 to RMB50,270 million for the six months ended June 30, 2003.

Refining and Marketing

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

Turnover Turnover increased 40.06% from RMB75,835 million for the six months ended June 30, 2002 to RMB106,213 million for the six months ended June 30, 2003. This increase was due primarily to the increases in the prices and sales volume of refined products. Due to the fact that the prices in the domestic refined products market were directly linked to the prices in the international refined products market, the significant increase in the prices of refined products in the international market resulted in increases in the prices of gasoline, diesel and kerosene.

Sales revenue from gasoline increased 42.80% from RMB20,807 million for the six months ended June 30, 2002 to RMB29,713 million for the six months ended June 30, 2003. This increase was due primarily to a significant increase in the price of gasoline. The average realised selling price of gasoline increased 30.64%, from RMB2,298 per ton for the six months ended June 30, 2002 to RMB3,003 per ton for the six months ended June 30, 2003.

Sales revenue from diesel increased 42.93% from RMB34,149 million for the six months ended June 30, 2002 to RMB48,808 million for the six months ended June 30, 2003. This increase was due primarily to a significant increase in the price of diesel. The average realised selling price of diesel increased 27.84%, from RMB2,167 per ton for the six months ended June 30, 2002 to RMB2,771 per ton for the six months ended June 30, 2003.

Sales revenue from kerosene increased 13.59% from RMB1,810 million for the six months ended June 30, 2002 to RMB2,056 million for the six months ended June 30, 2003. This increase was due primarily to a significant increase in the price of kerosene. The average realised selling price of kerosene increased 31.69% from RMB1,871 per ton for the six months ended June 30, 2002 to RMB2,464 per ton for the six months ended June 30, 2003.

Intersegment sales revenue increased 101.55% from RMB4,001 million for the six months ended June 30, 2002 to RMB8,064 million for the six months ended June 30, 2003. This increase was due primarily to a significant increase in the sales volume and price of refined products.

Operating Expenses Operating expenses increased 38.74% from RMB74,346 million for the six months ended June 30, 2002 to RMB103,146 million for the six months ended June 30, 2003. This increase was due primarily to an increase in the costs of crude oil purchased as a result of an increase in the price of crude oil and an increase in employee compensation costs as a result of the development in marketing activities.

Profit From Operations Profit from operations increased 105.98% from RMB1,489 million for the six months ended June 30, 2002 to RMB3,067 million for the six months ended June 30, 2003.

Chemicals and Marketing

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

Turnover Turnover increased 41.73% from RMB13,355 million for the six months ended June 30, 2002 to RMB18,928 million for the six months ended June 30, 2003. This increase was due primarily to increases in the sales volume and prices of chemical products.

Operating Expenses Operating expenses increased 30.36% from RMB14,023 million for the six months ended June 30, 2002 to RMB18,280 million for the six months ended June 30, 2003. This increase resulted primarily from increases in purchases, services and other expenses due to increases in the prices of raw materials.

Profit From Operations The chemicals and marketing segment made a profit of RMB648 million for the six months ended June 30, 2003, compared to a loss of RMB668 million for the six months ended June 30, 2002.

Natural Gas and Pipeline

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

Turnover Turnover increased 22.55% from RMB6,346 million for the six months ended June 30, 2002 to RMB7,777 million for the six months ended June 30, 2003. This increase was due primarily to a 15.49% increase in the sales volume of the natural gas segment, from 242.7 billion cubic feet for the six months ended June 30, 2002 to 280.3 billion cubic feet for the six months ended June 30, 2003.

Operating Expenses Operating expenses increased 16.58% from RMB5,538 million for the six months ended June 30, 2002 to RMB6,456 million for the six months ended June 30, 2003. This increase was due primarily to an increase in the costs of natural gas purchased resulting from an increase in the sales volume of natural gas.

Profit From Operations Profit from operations increased 63.49% from RMB808 million for the six months ended June 30, 2002 to RMB1,321 million for the six months ended June 30, 2003.

Liquidity and Capital Resources

For the six months ended June 30, 2003, the Group's primary sources of funding were cash generated from operating activities and short-term and long-term borrowings. 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 at June 30, 2003, short-term borrowings comprised 5.97% of our capital employed as compared with 5.07% as at June 30, 2002. 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 of our refining and marketing segment, chemicals and marketing segment and the natural gas and pipeline segment.

We plan to fund the capital and related investments principally through the cash provided by operating activities, short-term and long-term borrowings. Net cash provided by operating activities for the six months ended June 30, 2003 was RMB66,828 million. As at June 30, 2003, we had cash and cash equivalents of RMB19,334 million. Cash and cash equivalents were primarily denominated in Renminbi (Renminbi accounting for approximately 95.04% and United States Dollar accounting for approximately 4.96%).

The table below sets forth our cash flows for each of the six months ended June 30, 2002 and 2003 and our cash and cash equivalents at the end of each period:

	Six months ended June 30,	
	2003	**2002**
	(RMB million)	**(RMB million)**
Net cash generated from operating activities	66,828	35,332
Net cash used for investing activities	(36,976)	(20,689)
Net cash used for financing activities	(20,495)	(12,553)
Cash and cash equivalents at the end of each period	19,334	13,217

Cash Generated from Operating Activities

Our net cash generated from operating activities increased from RMB35,332 million for the six months ended June 30, 2002 to RMB66,828 million for the six months ended June 30, 2003. This increase was due primarily to increases in turnover and profit from operations.

As at December 31, 2002, we had a working capital deficit of RMB14,189 million. As at June 30, 2003, we had a working capital deficit of RMB2,428 million. This decrease in working capital deficit was due primarily to the increase in sales in the first half of this year, timely collection of payment of goods, increases in cash and cash equivalents.

Cash Generated from (or Used for) Financing Activities

Our net borrowings as at June 30, 2003 and December 31, 2002 were as follows:

	June 30, 2003	December 31, 2002
	(RMB million)	(RMB million)
Short-term borrowings (including current portion of long-term borrowings)	25,129	20,633
Long-term borrowings	47,776	60,655
Total borrowings	72,905	81,288
Less:		
Cash and cash equivalents	19,334	9,977
Time deposits with maturities over three months	2,627	2,612
Receivables under resale agreements	19,854	9,786
Net borrowings	31,090	58,913

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

	Principal as at June 30, 2003
	(RMB million)
To be repaid within one year	16,048
To be repaid within one to two years	18,570
To be repaid within two to five years	21,182
To be repaid after five years	8,024
	63,824

Of the total borrowings of the Group as at June 30, 2003, approximately 23.73% were fixed-rate loans and 76.27% were floating-rate loans. Of the total borrowings as at June 30, 2003, approximately 80.01% were denominated in Renminbi, approximately 16.93% were denominated in United States Dollar, approximately 1.69% were denominated in British Sterling, approximately 0.81% were denominated in Japanese Yen and approximately 0.56% were denominated in Euro.

As at December 31, 2002 and June 30, 2003, the amount of short-term borrowings owed to the related parties were RMB570 million and RMB430 million, respectively. As at December 31, 2002 and June 30, 2003, the amount of long-term borrowings owed to the related parties were RMB24,132 million and RMB24,386 million, respectively.

As at June 30, 2003, our borrowings owed to related parties primarily included short-term and long-term borrowings owed to China Petroleum Finance Company Limited of RMB430 million and RMB24,386 million, respectively.

Our net cash used for financing activities for the six months ended June 30, 2003 increased 63.27% compared with the six months ended June 30, 2002. This increase was primarily due to the sufficiency in cash to repay some long-term borrowings and an increase in dividend payment.

As at June 30, 2003, the bank loans of the Group consisted of RMB36 million secured loans (RMB276 million as at December 31, 2002) secured by plant and equipment of the Group that worth RMB62 million (RMB426 million as at December 31, 2002). As at June 30, 2003, the debts incurred by the Group by way of financing lease amounted to RMB81 million (RMB122 million as at December 31, 2002). The net book value of the properties, plant and equipment under financing lease was RMB256 million (RMB399 million as at December 31, 2002).

The debt to capitalisation ratio (debt to capitalisation ratio = interest-bearing debts/(interest-bearing debts + shareholder's equity)) as at June 30, 2003 was 17.53% (20.43% as at December 31, 2002).

Capital Expenditures

The table below sets forth our capital expenditures by business segment for each of the six months ended June 30, 2003 and the six months ended June 30, 2002. Capital expenditures increased 17.52% from RMB22,591 million for the six months ended June 30, 2002 to RMB26,548 million for the six months ended June 30, 2003. The increase was due primarily to the construction of the West-East gas pipeline project, increased expenditures relating to the oil and gas exploitation, refining and petrochemical projects.

	For the six months ended June 30,					
	2003		2002		2003 (estimated value)	
	(RMB million)	%	(RMB million)	%	(RMB million)	%
Exploration and production*	17,336	65.3	16,303	72.2	44,280	57.4
Refining and marketing	3,558	13.4	2,739	12.1	9,463	12.3
Chemicals and marketing	1,123	4.2	790	3.5	5,737	7.4
Natural gas and pipeline	4,492	16.9	2,645	11.7	17,000	22.1
Other	39	0.2	114	0.5	600	0.8
Total	26,548	100.0	22,591	100.0	77,080	100.0

Note*: If the investments relating to geological and geophysical exploration costs were included, the capital expenditures and investments for the exploration and production segment for the first half of 2003, the first half of 2002 and the estimated value for the entire year of 2003 would be RMB19,132 million, RMB18,025 million and RMB49,100 million, respectively.

Exploration and Production

The majority of the Group's capital expenditures and investments relate to the exploration and production segment. Capital expenditures of the exploration and production segment for the six months ended June 30, 2003 totalled RMB17,336 million, including RMB2,594 million for exploration activities and RMB13,909 million for development activities. Capital expenditures for the six months ended June 30, 2002 totalled RMB16,303 million, including RMB3,213 million for exploration activities and RMB13,064 million for development activities. The increase in our capital expenditures from the six months ended June 30, 2002 to the six months ended June 30, 2003 was due primarily to an increase in expenditures relating to oil and gas exploitation wells.

We anticipate that capital expenditures and investments for our exploration and production segment for the year ending December 31, 2003 will amount to RMB49,100 million, of which capital expenditures will amount to RMB44,280 million. Approximately RMB7,609 million of the capital expenditures is expected to be used for oil and gas exploration activities and approximately RMB34,371 million for oil and gas development activities. We plan to focus our exploration efforts on the Tarim basin for natural gas and on the Erdos, Junggar and Songliao basins for oil.

Refining and Marketing

Capital expenditures for the Group's refining and marketing segment for the six months ended June 30, 2003 were RMB3,558 million, of which RMB1,154 million was spent on the expansion of the retail marketing network of our refined products and storage infrastructure facilities, and RMB2,404 million was spent on the renovation of our refining facilities. Total capital expenditures for the six months ended June 30, 2002 were RMB2,739 million. The increase in capital expenditures from the six months ended June 30, 2002 to the six months ended June 30, 2003 was due primarily to the expansion and upgrading of refining facilities.

We anticipate that capital expenditures and investments for our refining and marketing segment for the year ending December 31, 2003 will amount to RMB9,463 million, which include approximately RMB4,663 million for investments in our refined product retail marketing network in order to add more service stations and storage facilities, and approximately RMB4,800 million for the construction and expansion of refining facilities.

Chemicals and Marketing

Capital expenditures for the Group's chemicals and marketing segment increased from RMB790 million for the six months ended June 30, 2002 to RMB1,123 million for the six months ended June 30, 2003. The increase in capital expenditures in the first half of this year was due primarily to increased efforts in structural adjustments involving increased investments in key engineering projects, in particular in the expansion of capacity and upgrading of olefine hydrocarbon projects.

We anticipate that capital expenditures and investments for our chemicals and marketing segment for the year ending December 31, 2003 will amount to RMB5,737 million, which include the capital expenditures and investments for the expansion of ethylene production capacity at Daqing petrochemical plant.

Natural Gas and Pipeline

Capital expenditures in the Group's natural gas and pipeline segment for the six months ended June 30, 2003 totalled RMB4,492 million. These capital expenditures included RMB4,417 million of the capital expenditures we spent on the construction of long distance pipelines of which RMB3,894 million was spent on the West-East gas pipeline project. The Group's capital expenditures for the six months ended June 30, 2002 totalled RMB2,645 million. The increase in capital expenditures from the six months ended June 30, 2002 to the six months ended June 30, 2003 was due primarily to the increased expenses for the West-East gas pipeline project.

We anticipate that capital expenditures and investments for our natural gas and pipeline segment for the year ending December 31, 2003 will amount to RMB17,000 million. Approximately RMB14,000 million is expected to be invested in the West-East gas pipeline project, RMB1,600 million is expected to be invested in the Zhong-Wu and the second Shaanxi-Beijing natural gas pipelines, approximately RMB900 million will be invested in the natural gas storage infrastructure projects and other natural gas pipeline and approximately RMB500 million will be used for investments in the transmission pipelines for crude oil and refined product.

Other

The Group's non segment-specific capital expenditures for the six months ended June 30, 2002 and the six months ended June 30, 2003 were RMB114 million and RMB39 million, respectively. The Group's non segment-specific capital expenditures 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, 2003 will amount to RMB600 million, which will be primarily used for the construction work of various segments for their mutual benefits.

Material Investment

The Group has no material investment for the six months ended June 30, 2003.

Material Acquisition or Disposal

The Group has no material acquisition or disposal for the six months ended June 30, 2003.

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. Although the PRC government currently adopts a stable foreign exchange policy and maintains substantial foreign exchanges reserves, 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. To date, we do not hedge against currency risks through the use of financial contracts or other agreements.

Employees

Number of Employees

As at June 30, 2002 and June 30, 2003, we had 421,012 and 419,415 employees, respectively. The table below sets forth the number of our employees by business segment as at June 30, 2003:

	Number of Employees	% of total
Exploration and production	233,831	55.75
Refining and marketing	113,244	27.00
Chemicals and marketing	59,264	14.13
Natural gas and pipeline	10,327	2.46
Other*	2,749	0.66
Total	419,415	100.00

Note*: Including PetroChina Exploration & Development Research Institute, PetroChina Planning & Engineering Institute and headquarters management.

Employee Compensation

The total employee compensation payable by the Company for the six months ended June 30, 2003 was RMB4,467 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 is based on the principles of attracting and retaining the high-calibre personnel, 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. We have entered into performance contracts with our senior management. 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 70% 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:

	Fixed salary (%)	Stock appreciation rights (%)	Performance bonus (%)
Chairman	30	70	0
President	25	60	15
Vice President	25	60	15
Department GM	25	50	25

Details of the directors' and supervisors' emoluments for the six months ended June 30, 2002 and the six months ended June 30, 2003 are as follows:

	Six months ended June 30,	
	2003	2002
	(RMB'000)	(RMB'000)
Fee for directors and supervisors	33	50
Salaries, allowances and other benefits	611	346
Contribution to retirement benefit scheme	18	13
	662	409

The numbers of directors and supervisors whose fees fall within the following bands:

	Six months ended June 30,	
	2003	2002
	Number	Number
Nil - RMB1,000,000	12	12

Upon exercise of their 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.

Workforce Reduction Plan

During the period from 1999 to 2002, a total of 58,300 people were laid off, which has met the target of laying off 50,000 employees committed originally by the Company.

The Company has no new plan to further reduce its workforce in large number in the next few years, but may lay off a small number of employees, having regard to the status of the shut-down of low efficiency or loss-making production installations.

Training Programmes

In order to develop the Company into a first-class international oil company, the Company will endeavour to carry out its training programmes this year with a special emphasis on learning. It will focus on the training of core employees, actively promote the training of all of its employees and strive to build up an operating and management team, a technology renovation team, a skillful operators' team and a team capable of conducting international business, so as to achieve an overall improvement in the quality of its staff and ensure the supply of talents required for the continuous, steady and rapid development of the Company.

Basic Medical Insurance for Employees

Since October 1, 2002, the Company has implemented the employees basic medical insurance measures (the "Measures") and other companies within the Group have also generally adopted such Measures.

According to the Measures, the employer will make contributions to the basic medical insurance premium at 6% to 10% of the total basic salaries of the employees. As the implementation of the Measures is subject to local policies, the implementation dates vary and there are certain differences between the specific regulations issued by various cities regarding the basic medical insurance.

As the difference between the amount to be paid by the Company in relation to basic medical insurance premium and that under the original payment terms for employees medical expenses is not substantial, there was little effect on the Company's financial position and no material effect on either the consolidated profit and loss statement or the consolidated balance sheet.

Contingent Liabilities

Information on the Group's contingent liabilities as of June 30, 2003 is as follows:

Bank and other guarantees

At June 30, 2003, 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 reasonably be estimated at present, and could be material. Under existing legislation, however, management believes that there are no probable liabilities, that are in addition to amounts which have already been reflected in the financial statements, that will have a material 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 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 material 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 in 1999 upon the formation of the Company, 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.

As at June 30, 2003, CNPC has obtained formal land use right certificates in relation to 22,670 out of the above-mentioned 28,649 parcels of land, some building ownership certificates for the above-mentioned buildings, but 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. In management's opinion, the outcome of the above events will not have a material 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 subject to 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 effect of under-insurance on future incidents cannot be reasonably assessed at present, management believes it could have a material impact on the operating results, but would not have a material adverse effect on the financial position of the Group.

Cost reduction measures

The Company may further streamline production and operation facilities within the next several years to further improve the operating efficiency and competitiveness of the Group. Management has not approved all significant actions to be taken to complete such plan. Management does not believe it will have a material adverse impact on the Group's financial position, but it could have a material adverse effect on the Group's results of operations.